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Abbreviations

AALCC	Asian-African Legal Consultative Committee
AC	Asian Corporatism
ACP	African, Caribbean and Pacific Group
ACU	Asian Currency Units
ADB	Asian Development Bank
AfDB	African Development Bank
AfDF	African Development Fund
AFESD	Arab Fund for Economic and Social Development
AFL	American Federation of Labor
AFTA	ASEAN Free Trade Area
AIC	ASEAN Industrial Complementation
AIJV	ASEAN Industrial Joint Ventures
AIOEC	Association of Iron Ore Exporting Countries
AIP	ASEAN Industrial Projects
ALADI	Latin American Integration Association
ANZCERTA	Australia-New Zealand Closer Economic Relations Trade Agreement
AOSIS	Alliance of Small Island States
APACS	Association for Payment Clearing Services
APC	Average Propensity to Consume
APEC	Arab Petroleum Exporting Countries
APRO	Asian and Pacific Regional Organization
APS	Average Propensity to Save
ARF	ASEAN Regional Forum
ASEAN	Association of South-East Asian Nations
ASEM	Asia Europe Meeting
ATC	Agreement on Textiles and Clothing
ATPC	Association of Tin Producing Countries
BDCCs	Buyer-Driven Commodity Chains
BINGO	Business International Non-Governmental Organization
BIS	Bank for International Settlements
BITs	Bilateral Investment Treaties
BWI	Bretton Woods Institution
CACEU	Central African Customs and Economic Union
CACM	Central American Common Market
CAP	Common Agricultural Policy
CARICOM	Caribbean Community
CBA	Cost-Benefit Analysis
CBO	Community-Based Organization
CCP	Chinese Communist Party
CD	Certificate of Deposit
CDM	Clean-Development Mechanism
CEAO	Union Economique de l'Afrique Occidentale

List of abbreviations

CES	Constant Elasticity of Substitution
CET	Common External Tariff
CFA	Communauté Financière Africaine
CFCs	Chlorofluorocarbons
CFSP	Common Foreign and Security Policy
CGE	Compagnie Générale d'Electricité
CGE	Computable General Equilibrium Model
CIA	Central Intelligence Agency
CIEC	Conference on International Economic Cooperation
c.i.f.	cost, insurance, freight
CIPEC	Intergovernmental Council of Copper Exporting Countries
CMEA	Council for Mutual Economic Assistance
COCOM	Coordinating Committee on Trade with Communist Nations
COFACE	Compagnie Française d'Assurance pour le Commerce Extérieur
COMESA	Common Market of Eastern and Southern Africa
CP	Commercial Policy
CPC	Central Product Classification
CPSU	Communist Party of the Soviet Union
CSE	Consumer Subsidy Equivalent
CU	Customs Union
CUSTA	Canada-United States Free Trade Agreement
DAC	Development Assistance Committee
DC	Developed Countries
DM	Debt Management
DM	Deutschmark
DMZ	Demilitarized Zone
DPRK	Democratic People's Republic of Korea
DRC	Domestic Resource Cost
DTCI	Division of Transnational Corporations and Investments
DUP	Directly Unproductive Profit Seeking
EAC	East African Community
EAEC	East Asian Economic Caucus
EBRD	European Bank for Reconstruction and Development
EC	European Community
ECA	United Nations Commission for Africa
ECAFE	Economic Commission for Asia and the Far East
ECB	European Central Bank
ECLA	Economic Commission for Latin America
ECOMOG	ECOWAS Monitoring Group
ECOSOC	Economic and Social Council
ECOWAS	Economic Community of West African States
ECSC	European Coal and Steel Community
ECU	European Currency Unit
EDF	European Development Fund
EEA	European Economic Area
EEC	European Economic Community
EFF	Extended Fund Facility
EFO	Embedded Financial Orthodoxy
EFTA	European Free Trade Association

List of abbreviations

EIA	Environmental Impact Assessment
EIB	European Investment Bank
ELM	Elaboration Likelihood Model
EMI	European Monetary Institute
EMS	European Monetary System
EMU	Economic and Monetary Union
EOI	Export-Oriented Industrialization
EP	European Parliament
EPC	European Political Cooperation
EPU	European Payments Union
EPZs	Export-Processing Zones
ERM	Exchange Rate Mechanism
ERP	European Recovery Program
ESAF	Enhanced Structural Adjustment Facility
ESCAP	Economic and Social Commission for Asia and the Pacific
ESEE	European Society for Ecological Economics
ETSI	European Technical Standards Institute
ETUC	European Trade Union Confederation
EU	European Union
EURATOM	European Atomic Energy Community
EZLN	Zapatista Army of National Liberation (Mexico)
FAO	Food and Agriculture Organization
FCCC	Framework Convention on Climate Change
FDI	Foreign Direct Investment
FDIC	Federal Deposit Insurance Corporation
FEA	Functional Economic Area
FECOM	European Monetary Cooperation Fund
FIBV	International Federation of Stock Exchanges
f.o.b.	Free on Board
FOCs	Flags of Convenience
FOX	Futures and Options Exchange
FRP	Falling Rate of Profit
FSCs	Foreign Sales Corporations
FSLIC	Federal Savings and Loan Insurance Corporation
FTA	Free Trade Area
FTAA	Free Trade Area of the Americas
G-3	Group of 3
G-5	Group of 5
G-7	Group of 7
G-7FM	Group of 7 Finance Ministers
G-8	Group of 8
G-10	Group of 10
G-77	Group of 77
GATS	General Agreement on Trade in Services
GATT	General Agreements on Tariffs and Trade
GBO	Grassroot-based Organization
GCCs	Global Commodity Chains
GDP	Gross Domestic Product
GEMS	Global Environmental Monitoring System

List of abbreviations

GIS	Graphical Information Systems
GLF	Great Leap Forward
GMAC	General Motors Acceptance Corporation
GNP	Gross National Product
GONGO	Government Organised Non-Governmental Organization
GSP	Generalised System of Preferences
GT	General Theory
HAI	Health Action International
HDI	Human Development Index
HDTV	High-Definition TV
HIPC	Highly Indebted Poor Countries
HOS	Heckscher-Ohlin-Samuelson
HS	Harmonized Commodity Description and Coding System
IACAC	Inter-American Commercial Arbitration Commission
IAEA	International Atomic Energy Agency
IATA	International Air Transport Association
IBA	International Bauxite Association
IBCC	International Bureau of Chambers of Commerce
IBEC	International Bank for Economic Cooperation
IBF	International Banking Facilities
IBM	International Business Machines
IBOS	Inter-Bank On-line System
IBRD	International Bank for Reconstruction and Development
ICA	International Coffee Agreement
ICA	International Commodity Agreement
ICAO	International Civil Aviation Organization
ICBMs	Intercontinental Ballistic Missiles
ICC	International Chamber of Commerce
ICFTU	International Confederation of Free Trade Unions
IDA	International Development Association
IDB	Inter-American Development Bank
IDEP	Institute of Economic Development and Planning
IDS	Institute of Development Studies
IEA	International Energy Agency
IFC	International Finance Corporation
IFPMA	International Federation of Pharmaceutical Manufacturers
IFT	Inter-Firm Trade
IFTU	International Federation of Trade Unions
IGCs	Intergovernmental Conferences
ILO	International Labour Organization
IMF	International Monetary Fund
IMO	International Maritime Organization
INCOTERMS	International Commercial Terms
INGOs	International Non-Governmental Organizations
I/O	Industrial Organization
IO	International Organization
IOM	International Organization for Migration
IOSCO	International Organization of Securities Commissions
IPC	Integrated Programme for Commodities

List of abbreviations

IPCC	International Panel on Climate Change
IPE	International Political Economy
IPPA	Investment Promotion and Protection Agreements
IPRs	Intellectual Property Rights
IR	Industrial Relations
IR	International Relations
ISEE	International Society for Ecological Economics
ISI	Import Substitution Industrialization
ISIC	National Standard Industrial Classifications
ISMA	International Securities Markets Association
ITA	International Tin Agreement
ITS	International Trade Secretariats
ITT	International Telephone and Telegraphy Company
ITU	International Telecommunication Union
ITU	International Telegraph Union
IWS	Industrial and Welfare State
JHA	Justice and Home Affairs
JIT	just-in-time
KDD	Kokusai Denshin Denwa
KPD	German Communist Party
LAFTA	Latin American Free Trade Association
LLDCs	Least-Developed Countries
LDCs	Less-Developed Countries
LED	Local Economic Development
LIBOR	London Inter-Bank Offer Rate
LIFFE	London International Financial Futures Exchange
LME	London Metal Exchange
LPA	Lagos Plan of Action
LSE	London School of Economics
MAD	Mutual Assured Destruction
MAI	Multilateral Agreement on Investment
MAW	Maximum Allowable Personal Wealth
MENA	Middle East and North Africa
MFA	Multi-Fibre Arrangement
MFN	Most-Favoured Nation
MIC	Military-Industrial Complex
MIT	Massachusetts Institute of Technology
MITI	Ministry of International Trade and Industry
MMC	Monopolies and Mergers Commission
MNCs	Multinational Corporations
MoR	Mode of Regulation
MPC	Marginal Propensity to Consume
MPS	Marginal Propensity to Save
NAFTA	North American Free Trade Area
NAM	Non-Aligned Movement
NATO	North Atlantic Treaty Organization
NBVs	Non-Basic Vouchers
NEP	New Economic Policy
NGDO	Non-Government Development Organization

List of abbreviations

NGOs	Non-governmental Organizations
NICs	Newly Industrialized Countries
NIDL	New International Division of Labour
NIE	New Institutional Economics
NIEO	New International Economic Order
NIMO	New International Maritime Order
NIT	Negative Income Tax
NLRA	National Labour Relations Act
NRA	National Recovery Association
NTBs	Non-Tariff Barriers (to trade)
NTMs	Non-Tariff Measures
NTMA	New Transatlantic Marketplace Agreement
NTT	Nippon Telegraph and Telephone
OAP	Offshore Assembly Provisions
OAPEC	Organization of Arab Petroleum Exporting Countries
OAS	Organization of American States
OAU	Organization of African Unity
OCC	Organic Composition of Capital
ODA	Official Development Assistance
ODF	Official Development Finance
OECD	Organisation for Economic Co-operation and Development
OIE	Original Institutional Economics
OMA	Orderly Marketing Agreement
OPEC	Organization of Petroleum Exporting Countries
OSCE	Organization for Security and Cooperation in Europe
OSS	Office of Strategic Services
OTC	over-the-counter
PC	Public Choice
PCI	Italian Communist Party
PDCCs	Producer-Driven Commodity Chains
PITPs	Preferential Industrial and Trade Policies
PLA	People's Liberation Party (China)
PLO	Palestine Liberation Organization
PPP	Purchasing Power Parity
p.s.c.	Progressive Social Change
PSE	Producer Subsidy Equivalent
PTA	Preferential Trade Agreement
PTO	Preferential Trade Arrangement
PVO	Private Voluntary Organization
QRs	Quantitative Restrictions
QTM	Quantity Theory of Money
QUANGO	Quasi-Autonomous Non-Governmental Organization
R&D	Research and Development
RAP	Rights Accumulation Programme
RCA	Revealed Comparative Advantage
RDBs	Regional Development Banks
REDWG	Regional Economic Development Working Group
RIIA	Royal Institute of International Affairs
RILU	Red International of Labour Unions

List of abbreviations

RMSM	Revised Minimum Standards Model
ROA	Regime of Accumulation
R of O	Regime of Accumulation
RSDLP	Russian Social Democratic and Labour Party
SACU	Southern African Customs Union
SADC	Southern African Development Community
SADCC	Southern African Development Coordination Conference
SAF	Structural Adjustment Facility
SAL	Structural Adjustment Loan
SALT	Strategic Arms Limitation Treaties
SAM	Social Accounting Matrix
SAP	Structural Adjustment Programme
SAP	Swedish Socialist Workers Party
SCP	structure-conduct-performance
SDI	Strategic Defense Initiative
SDR	Special Drawing Right
SEA	Single European Act
SEANWFZ	South-East Asian Nuclear Weapon-Free Zone
SECAL	Sector Adjustment Loan
SeD	Socioeconomic Democracy
SEM	Single European Market
SEP	Sector Expenditure Programme
SFB	State-Firm Bargaining
SILICs	Severely Indebted Low-Income Countries
SIP	Sector Investment Programme
SIPRI	Stockholm International Peace Research Institute
SITC	Standard International Trade Classifications
S&L	Savings and Loans
SLBMs	Submarine-Launched Intercontinental Missiles
SMO	Social Movement Organization
SOE	State-Owned Enterprise
SOLAS	Safety of Life at Sea
SORO	Socially Optimum Rate of Output
SPD	German Social Democratic Party
SRC	Semiconductor Research Corporation
SSA	Social Structure of Accumulation
STA	Semiconductor Trade Arrangement
SUNFED	Special United Nations Fund for Economic Development
SWMTEP	System-wide Medium-term Planning
TAFTA	Trans-Atlantic Free Trade Area
TCC	Technical Composition of Capital
TEFRA	Tax Equity and Fiscal Responsibility Act
TENs	Trans-European Networks
TEU	Treaty on European Union
TIP	Tax-based Incomes Policy
TNCs	Transnational Corporations
TOES	The Other Economic Summits
TQM	Total Quality Management
TRI	Trade Restrictiveness Index

List of abbreviations

TRIPs	Trade Related Intellectual Property Measures
TRP	Technology Reinvestment Project
TRQ	Tariff-Rate Quota
UAE	United Arab Emirates
UB	Urban Bias
UCC	Universal Copyright Convention
UDE	Union Douanière Equatoriale
UDEAC	Union Douanière et Economique de l'Afrique Centrale
UEMAO	Union Economique et Monétaire de l'Afrique Occidentale
UGI	Universal Guaranteed Personal Income
UN	United Nations
UNCITRAL	United Nations Centre for International Trade Law
UNCTAD	United Nations Conference on Trade and Development
UNDP	United Nations Development Programme
UNEMOA	West African Economic and Monetary Union
UNEP	United Nations Environmental Programme
UNESCO	United Nations Education, Social and Cultural Organization
UNFPA	United Nations Population Fund
UNIDO	United Nations International Development Organization
UNRRA	UN Relief and Rehabilitation Administration
UNSC	UN Security Council
UPU	Universal Postal Union
USPD	Independent Social Democrat Party of Germany
USTR	United States Trade Representatives
VAT	Value Added Tax
VCC	Value Composition of Capital
VERs	Voluntary Export Restraints
WAMU	West African Monetary Union
WARC	World Administrative Radio Conference
WFTU	World Federations of Trade Unions
WHO	World Health Organization
WID	Women in Development
WIPO	World Intellectual Property Organization
WMO	World Meteorological Organization
WTO	World Trade Organization
WWCR	Worldwide Combined Reporting
XE	X-Efficiency
ZOPFAN	Zone of Peace, Freedom and Neutrality

Introduction

International political economy has blossomed as an academic subdiscipline during the last three decades. The economic dimension of international affairs had suffered acute neglect, and often denial, under the practical and intellectual pressures of the Cold War. As the Cold War began to wane, however, interest in international political economy revived and was gradually restored to a legitimate place within the study of international relations.

International political economy, as it appears at the start of the twenty-first century, is definitionally elusive and substantively diverse. The difficulty with defining international political economy is that of differentiating it from comparative political economy and other close relatives such as world-systems theory and analysis. Differentiating *international* political economy is a particularly difficult, and possibly futile, task. Theories and concepts relating, for example, to the management of domestic economies or developmental projects have a clear significance for, and considerable overlap with, international political economy.

International political economy is also highly diverse in substance – empirically and theoretically. The range of issues and developments that are pertinent to international political economy, as it is generally understood, is enormous. The range of perspectives, analytical dispositions and institutional contexts within which international political economy is addressed is also of considerable breadth. ‘Traditional’ Marxist, realist and liberal perspectives now rub shoulders and often discord sharply with critical, constructivist and even post-modernist approaches. International political economy, in one sense or another, is also studied in university departments of politics and political science, sociology, geography, development studies and conventional economics, and beyond academe in governmental

research departments, international agencies, myriad ‘think tanks’ and in pressure groups of many interests.

The range of issues, concepts and theories that has been identified and developed within international political economy makes the production of an encyclopedia of the subject more than timely. This very range, however, suggests the considerable problems of inclusion and exclusion that would be encountered in the development of such an encyclopedia. It also hints at the practical problems that would be (and indeed were) encountered in its production. Widespread consultation was undertaken over the topics that ought to be included in the encyclopedia. An initial list of some 500 entries rapidly expanded into a ‘wish list’ of nearer to 1,500. Critical reflection upon this list led to the elimination of a number of the more obscure or ephemeral terms and concepts, and practical problems of commissioning led to the loss of a few more.

The preservation of intellectual and analytical diversity was a clear and firm intention from the early days of the encyclopedia. Such diversity is essential if the complexity, diversity and dynamic quality of the contemporary international political economy is to be apprehended, if empirical surprises are to be minimized and if analytical (or doctrinal) rigidity is to be avoided.

The entries that thus appear in the encyclopedia are intended to embrace the range of the major issues within the empirical realm of the international political economy and the concepts and theories deployed by a wide range of those who are currently engaged in its study and discussion. It is also intended that the entries in the encyclopedia will provide new students of the subject with an effective introduction to a wide range of theories, concepts and issues, while also offering interesting

Introduction

and valuable discussions to established students and practitioners.

The preparation of the *Routledge Encyclopedia of International Political Economy* was a demanding process that took more than five years. The complexity of the task, the range of entries, the large number of contributors and the not infrequent staffing upheavals at Routledge all contributed to the time consumed by the project. We hope, however, that the time lapse between the writing of the earliest contributions and the final publication of this encyclopedia will not result in any loss of pertinence or timeliness.

The number of those who deserve heartfelt thanks for the preparation and production of the encyclopedia is literally huge. Particular

thanks must, however, be expressed to the encyclopedia's team of Associate Editors; the editorial team of the *Review of International Political Economy*, from whom came the original proposal for the encyclopedia; successive editors at Routledge – Mark Barragry, Samantha Parkinson, Mina Gera-Price, Ben Swift and Stephanie Rogers; my wife Stephanie for her unstinting support and encouragement; and finally, by no means least, the numerous hard-working authors and authorities who, in the final analysis, contributed the substance of this publication.

R.J. Barry Jones

18 September 2000

A

absolute advantage

ADAM SMITH, among others, asserted the principle that each nation should export those goods in which it possessed 'natural and acquired advantages' in productive EFFICIENCY and should import those goods in which other nations held an advantage in productivity. Smith cited such characteristics as land quality and specialized artisan skills to explain why one nation could produce a given product while consuming fewer units of labour power than would be used by a nation less well endowed. He argued that a pair of nations could maximize their production through specialization and trade, provided that each could produce at least one product with less labour power than the other. After DAVID RICARDO later showed that trade could be profitable even between a pair of nations in which one was more efficient than the other in all products, Smith's more limited argument was christened 'absolute advantage', while Ricardo's broader claim (which relied on comparative opportunity costs) became known as 'comparative advantage'.

See also:

comparative advantage

BRUCE E. MOON

absolutist states

Absolutism refers to a form of state that is based on (1) the absorption of smaller and weaker political units into larger, more effective bureaucratic political structures; (2) a strength-

ened ability to rule over a unified territorial area; (3) a centralized system of law and order, and (4) the application of a more unitary and effective government by a single, sovereign ruler. Absolutist states came to dominate most of the European landscape between the sixteenth and eighteenth centuries. Between the eighth and the fourteenth centuries, the political system that prevailed in Europe was highly decentralized, with each local lord enjoying legal, fiscal and military prerogatives of rule. This system – defined by some historians as 'feudal' – was one of overlapping power and divided authority between lords, towns, churches, estates and so forth. Under absolutism, ownership of the means of violence became a monopoly of the sovereign ruler. The right to make war, to tax, to exercise ultimate jurisdiction and to coin money was limited to the state. Absolutist states also consciously promoted economic development through mercantilist policies (see MERCANTILISM) in order to build up the state's treasury. Absolutist states were replaced in varying degrees by parliamentary forms of government.

Four major interpretations have been put forth explaining the rise of absolutist states, of which three are Marxist in orientation. One view, advanced by Friedrich Engels, maintains that absolutist states were created in order to mediate the economic interests of the old feudal nobility and the ascending bourgeoisie. This argument sees the state as a kind of balancing instrument intended for a period of transition in which an old feudal ruling class and a newly emerging capitalist one were still competing for power. Since neither class was truly dominant, the state attempted to serve the economic interests of both. IMMANUEL WALLERSTEIN argues that emerging capitalist

absorptive capacity

relations required a 'strong' state in the core areas of Europe to ensure their domination and exploitation of the 'periphery'. Another Marxist view, elaborated by PERRY ANDERSON, is that absolutist states were formed to protect the economic interest of the old feudal nobility during a period in which the growth of manufactures and commercial relations had weakened its economic interests. Since the rise of CAPITALISM had ended servile relations between lord and serf, the landlord class could no longer ensure its traditional exploitation of the peasantry: this class required a new and more effective state apparatus to enforce their continued exploitation of the peasants. Finally, there is a neo-Weberian view which argues that war and preparation for war fundamentally affected the entire process of state centralization. Michael Mann, for example, provides figures for state finances that suggest that the functions of the absolutist states were overwhelmingly military and geopolitical, rather than economic or domestic: Louis XIV (1638–1715) spent around 75 per cent of his revenue on war; Peter the Great (1672–1725) around 85 per cent.

See also:

feudalism; neo-Weberian approaches; serfdom; state theory

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RICARDO DUCHESNE

absorptive capacity

Used in its broadest sense, the 'absorptive capacity' of an economy refers to its ability to use aid funds 'wisely and productively' (Todaro, 1994: 545). Constraints on growth and development which cannot easily be quantified – administrative capacity, the supply of skilled labour, entrepreneurship, the capacity of an economy to undergo social and institutional change – are all indicators of absorptive capacity.

The original formulation of absorptive capacity had a rather narrower focus. Rosenstein-Rodan (1961) suggested that one possible measure of absorptive capacity was a country's past rate of increase in investment expenditure and that aid should be distributed between countries according to the degree of induced domestic effort in the recipient countries (Thirlwall, 1994: 349). In effect, this would mean that a principal condition of aid to a particular recipient should be that the marginal rate of savings was higher than the average rate, taking into account organizational and administrative capacities. As Thirlwall (*ibid.*: 348) notes, this ignores the varying levels of productivity on past investment, neglects future productivity and implies that before countries receive aid they should be able to demonstrate their capacity to develop. Although intuitively attractive, the concept of absorptive capacity is not rigorously defined and remains something of a 'black box' whose inner workings are not fully explained (Eckaus, 1989).

See also:

two-gap model

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FREDERICK NIXSON

accelerator principle

The 'accelerator principle' describes the effect on investment of changes in national income. If δY represents an increase or decrease in national income which stimulates investment I , then

$$I = \alpha \cdot \delta Y$$

where α is the so-called 'accelerator coefficient'. Since I corresponds to an increment δK in the capital stock, $\alpha = \delta K / \delta Y$, the marginal capital/output ratio.

Use of the term 'accelerator' arises because a small increase in output may induce substantial investment growth. As an example, consider a manufacturing company, assumed to be typical of many, with a capital stock of ten machines, each of which lasts ten years and is used to capacity. The spread of ages of the machines is assumed to be uniform between one and ten years, so that each year one machine wears out and is replaced to maintain production capacity in the face of constant demand. Now, suppose that demand for the firm's output increases by 10 per cent. An additional machine is required to satisfy the increase, requiring that two machines be purchased in the year in question: one of the new machines constitutes 'replacement' investment, while the other (to which the accelerator applies) is 'induced' investment.

A 10 per cent increase in demand has thus led to a 100 per cent increase in investment for the firm. Downturns in demand for its output will similarly tend to produce more than proportional *reductions* in investment. Hence the term 'accelerator'.

While the reality is considerably more complex than this example suggests, it is true that demand for investment goods tends to be

particularly volatile in the face of fluctuations in national income. The machine tool and construction industries, for example, tend to provide exaggerated reflections of the state of the overall economy, facing particularly high demand for their products in expansionary periods and suffering particularly badly in recessions.

JOHN CLARK

accumulation, logic of

The term 'accumulation' commonly refers to the formation of stocks: stocks of commodities, money or means of production. From the point of view of enterprises in a capitalist economy, these are all *forms* of capital. Hence accumulation refers here to the accumulation of capital. Today, use of the concept of accumulation is confined to Marxian theory.

The balance sheet of an enterprise provides a report of the stocks of means of production (plant and equipment), commodities and money; together with any outstanding debts and claims, these sum up the enterprise's capital at one particular point in time. Such an account is a static one. Considered dynamically, the capital of an enterprise is always in process, flowing through the subsequent phases of its circuit: (1) the entrepreneur, starting with *money capital*, (2) buys means of production (plant, equipment, raw materials) and labour-power; when these are set into operation capital is in the phase of *productive capital*, (3) the result of which is the production of commodities and capital, now in the phase of *commodity capital*; (4) the commodities can now be sold for money, and the system cycles back to its starting point (1).

However, the logic of a capitalist economy requires that the result of Phase (4) includes a profit above the sum of money capital that was the starting point. Allowing for a degree of consumption out of profits (perhaps via dividends paid out), the investment of the remaining net profits accumulates to the money capital. Thus the capital circuit may develop on an expanded scale. This is, in

accumulation, logic of

essence, the process of what is usually called ECONOMIC GROWTH.

Note that for service sectors in the economy, Phase (2) and Phase (3) of the circuit coincide (the service being the direct product), with the particularity that services cannot be accumulated. Note also that at the start, all or part of the money capital may have been borrowed: at Phase (4) this sum may in principle return to the lender, together with interest, usually leaving the enterprise a sum of profits net of interest (see FINANCE CAPITAL).

The metamorphosis of capital in each of the phases provides ample room for interruption, from which capital may get stuck in one of the phases of its circuit (see DISPROPORTIONALITY: OVERPRODUCTION). While the term 'accumulation' bears the connotation of 'stock', the continuous accumulation of capital requires any stock to be in continuous flow in the circuit. Once an entrepreneur or group of entrepreneurs holds on to one of the three guises of capital, this multiplies into interruptions of the total economy, so enforcing others also to hold on to one particular guise of capital. For example, if entrepreneurs hold on to the guise of capital as accumulated in Phase (4) of the circuit (money capital), they force sellers of means of production to get stuck in their Phase (3) (commodity capital) – similarly, the labour-power that the entrepreneurs no longer hire cannot buy commodities.

The logic of a capitalist economy requiring, as mentioned, a profit above the sum of money that was the starting point, distinguishes it from other modes of production (see MODE OF PRODUCTION). Whereas the aim of production in general is the transformation of inputs into qualitatively different outputs, the capitalist profit-motive subordinates that transformation to merely a condition: the aim is to make more money, the type of transformation being auxiliary. Whereas for other modes of production qualitative difference is the object, the capitalist economy is rather guided by similarity and quantity: more of the same, that is more money capital at the end in comparison to the amount at the starting point. Therefore, accumulation indeed takes the form of accumulation of

capital. Its amount is determined by the amount of non-consumed profits; its pace by the rate of accumulation (that is, the amount of non-consumed profits over the amount of capital laid out at the starting point of the circuit). In essence, then, the logic of the accumulation of capital is the further expansion of accumulation via the expansion of profits.

The expansion of accumulation, however, is hampered by two complementary counteracting tendencies that this very accumulation of capital brings forth, each by itself producing a cyclical expansion. First, accumulation tends to expand beyond the point where there is a sufficient reserve of labour-power to feed production, the result being increasing wages and decreasing profits. Thus, there develops a decreasing rate of accumulation and, hence, decreasing growth and again the development of a reserve of labour-power with decreasing wages and increasing profits and accumulation. Thus we have a cyclical path of increasing and decreasing rates of accumulation.

Opposed to this there is a second cyclical process which stems from the tendency to relative expulsion of labour due to extensive technical development, as resulting in the tendency for the rate of profit to fall – see FALLING RATE OF PROFIT (FRP). However, a general fall in the rate of profit (be it that of one sector or that of the whole economy) will cyclically be countered by restructuring capital, scrapping plant and equipment: these, together with the ensuing unemployment, bring wages down and profits up, restore the rate of profit and thus lay the foundation for a renewed cycle of accumulation of capital.

What these two cyclical processes have in common is that in each case we see the ebb and flow of profit rates and rates of capital accumulation resulting in expansions and contractions of the economy. Their intertwining with the waxing and waning of credit granted by the financial sector, introduces the risk that these contractions will be accompanied by FINANCIAL CRISIS. In effect, therefore, the logic of the accumulation of capital is not only the logic of recurrent unemployment, but also that of a recurrent de-accumulation – in

fact, the partial destruction of what was previously built up.

See also:

neo-Marxism

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GEERT REUTEN

acquis communautaire

The existence and operation of the EUROPEAN UNION (EU) is based on law. The Treaty of

Paris (1951), Treaties of Rome (1957), Merger Treaty (1965), Single European Act (1985), Maastricht Treaty (1992) and the Treaty of Amsterdam (1997) together form the primary law of the EU. Secondary (or derived) law basically consists of legal acts promulgated by the institutions of the EU. 'Regulations' are compulsory and general in their application. They are to be directly implemented in all member-states and they overrule the national law where it exists counter to these regulations. 'Directives' are compulsory regarding the final outcome, but the member-countries have the freedom to select how they are implemented. 'Decisions' are binding for the subjects (governments, associations, firms, individuals and so on) to which they refer. The implementation of 'recommendations' and 'opinions' is not compulsory. The whole body of applicable EU legislative acts is called the *acquis communautaire*. It is estimated that the *acquis* consisted of around 80,000 pages of legal acts in 1998. The ever evolving and expanding *acquis* was enlarged by 2,653 new regulations in 1997 alone. However, most of the regulations have a limited time-duration. If an external country wants to join and is accepted by the EU, it has to accept, implement and enforce the entire *acquis*. This is particularly important regarding the legislation that deals with the Single European Market and competition. The EU member-countries that have certain derogations (opt-outs) from the *acquis* have these advantages over the potential new entrants because they were already inside the EU when the *acquis* was negotiated and agreed. Various derogations create opportunities for the 'multi-speed EU' and their absence may prevent countries from exercising their right to participate in the decision-making process and enjoying benefits of full membership of the EU. The EU *AGENDA 2000* stated that derogations from the *acquis* will not be permitted in the future and that, on accession, the new member-countries will have to implement the entire *acquis* that deals with the Single European Market.

MIROSLAV N. JOVANOVIĆ

acquisitions

Acquisitions quite often refer to the purchase of a non-like firm by another, whereas mergers are generally described as the combination of two like firms. The key difference is that the firms are not related – for example, the acquisition of a financial services firm by a manufacturing firm. Quite often, acquisitions take place for one of the following three reasons: diversification of risk factors, reduction of transaction costs and/or asset exploitation.

Diversification of risk factors

Orthodox economics literature often suggests RISK reduction as a reason for acquisitions. For example, a firm with high degrees of EXCHANGE RATE exposure or seasonal demand may wish to acquire another non-like firm to smooth out the seasonality or to assist in the exchange rate HEDGING process. In the latter case, a likely acquisition may be the purchase of a financial services firm. A firm wishing to reduce a certain type of risk may engage in acquisition, but may also engage in merger or conglomeration.

Reduction of transaction costs

In the heterodox economic literature, the reduction of transaction costs is also cited as a motivation for acquisition. The existing institutional arrangement might generate high transaction costs among the firms that have an established relationship (North, 1990; Coase, 1986 [1937]). The acquiring firm may try to reduce these transaction costs by purchasing the related firm in order to internalize the market imperfection, thereby eliminating the transaction cost (Williamson, 1986). A monopolistic supplier of raw materials, for example, can be acquired by the downstream producer in order to eliminate the cost of transacting. This explanation can be seen as a strong motivator in the purchase of up- or downstream (but not like) firms in a particular production stream.

Asset exploitation

Firms also engage in acquisition in order to exploit or to gain some sort of firm-specific asset, such as a patented technology, a specific management advantage, capital sourcing or similar advantages (Bain, 1968; Dunning, 1991). By nature, a firm will only engage in this sort of acquisition if the asset can remain internalized. A firm hoping to gain the advantage of another will purchase one whose advantage is believed to be applicable to the acquirer. Acquisitions for asset exploitation allow the firm to internalize market imperfections, such as those caused by information impactedness. The desire to gain an exploitable asset can be seen as efficiency reducing, since it may give a particular firm a greater market advantage (Coase, 1986 [1937]).

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ARIC KRAUSE

actors

The term 'actors' within the study of international relations (IR) and INTERNATIONAL POLITICAL ECONOMY (IPE) denotes all those entities – states, international organizations (IOs) and private interests – that have a

presence, or an influence, on the world stage. Interest in the wider range of actors reflected the weakening intellectual hold of state-centric REALISM on thinking about IR as the COLD WAR waned and then ended, and as interest grew in the complexities of IPE and the role within it of non-state actors like MULTINATIONAL CORPORATIONS (MNCs), business associations, non-governmental organizations (NGOs), interest and/or pressure groups, and any others capable of both legitimate and illegitimate action across state frontiers.

R.J. BARRY JONES

adjustment

Because states exist within the context of an international political economy and because no state has the POWER to unilaterally impose its will on other states, all states must (to varying degrees) adjust the policies they pursue at home and abroad (see STATE, THE). Generally, however, the scholarship on adjustment has asked the question: What (1) policies, (2) networks of interest and policy actors, and (3) institutions are created by state leaders and citizens to help states initiate programmes and policies that allow states to compete successfully within the international political economy?

There have been four major schools of thought that have analysed the adjustment processes and policies of states since World War II: (1) institutionalists, old and new (see INSTITUTIONALISM); (2) dependency theorists (see DEPENDENCY THEORY); (3) those who study the evolving roles of international financial institutions, especially supporters and critics of STRUCTURAL ADJUSTMENT PROGRAMMES (SAPs), and (4) GLOBALIZATION theorists.

Older institutionalists have argued that the configuration of politically administrative and legal structures of a state hinder or assist its abilities to function and to adjust and compete in the international system. Newer institutionalists have analysed the patterned interactions

of state structures and the norms, ideas and rules that guide participants within the formal structures of the state, as well as among those who informally ally with or lobby state actors. This approach yields insight into why one policy initiative was chosen over another, as states seek to adjust to the changing characteristics of the international political economy. The new institutionalists are especially careful to consider the agency of actors within state networks and institutions in determining their interests and advocating alternative choices from which states must choose and create policy initiatives of adjustment. Japan's ability to adjust to a new post-World War II international political economy, for example, has often been attributed to the elite networks that formed among business and state administrators to strategize, plan and implement national-level policy initiatives that made Japanese businesses competitive and expansionary in an international political economy initially dominated by the United States. Although free market ideas were advocated by many advanced industrial states, Japan found ways to compete within a free market international system while not complying with its norms. In Europe, as another example, alternatively structured and alternatively inclusive policy networks produced divergent responses to economic shocks in the post-war period.

Dependency theorists argue that international structures constrain states' ability to adjust and effectively compete in international systems. Some have argued that international norms supported by the West (and especially the United States) prevented Latin American states from adjusting effectively during the post-World War II period when civilian-led governments governed most Latin American states. Neither strategies of export nor of IMPORT SUBSTITUTION INDUSTRIALIZATION (ISI) provided Latin American states with effective strategies for development. The failure of these civilian administrations allowed bureaucratic-authoritarian military regimes (see BUREAUCRATIC AUTHORITARIANISM) to achieve popular backing and take over states throughout Latin America. These regimes

adjustment assistance

promised both to achieve economic development and ensure security, as their countries sought ways to adjust to the international constraints imposed by Western powers.

Those who analyse international FINANCIAL INSTITUTIONS offer both support and criticism for the structural adjustment policies advocated under the strict CONDITIONALITY regime for lending that has been adopted by the WORLD BANK and the INTERNATIONAL MONETARY FUND (IMF) since the 1980s. These two financial institutions have created programmes by which they insist late industrializing countries will be able to adjust successfully to the challenges of the international political economy. These SAPs include domestic policies to alter the provision and amount of domestic credit, public sector deficit spending practices, the amount of national financial reserves, external debt levels and payout procedures, exchange rates (see EXCHANGE RATE), INTEREST RATES, the prices of COMMODITIES, employment, tax and subsidy measures (see SUBSIDIES), export promotion, the provision of social services, government recordkeeping practices, and levels of government employment. Critics argue that such programmes may help a state's BALANCE OF PAYMENTS profile as the state tries to adjust to changing international conditions, but it condemns several generations of citizens to impoverishment, malnutrition and limited access to healthcare, greatly inflating mortality rates.

Globalization theorists have tended to expand scholars' concerns about adjustment from the earlier focus on mainly economic affairs to analyse how states must adjust their technologies, training programmes, educational systems and political institutions, as well as diversify their economies, to achieve parity with advanced industrial states. Many of these theorists are concerned with societal links that bypass states, but which affect the abilities and resources of citizens living within states. Many of these theorists see an adjustment of taste preferences that is homogenizing cultures internationally. Others see the threat of homogenization of cultures being used as a mobilizing force for new elites to come to power to

resist the Western HEGEMONY of ideas, technologies and organizational systems. These elites do not seek to adjust, but rather to resist or isolate themselves from the new globalizing international forces.

EVE SANDBERG

adjustment assistance

'Adjustment assistance' refers to government programmes designed to ease the burden on workers from import competition or other shocks, external (TERMS OF TRADE changes) or internal (TECHNOLOGICAL CHANGE). Adjustment programmes can include temporary protection, direct SUBSIDIES and worker re-training schemes.

STEPHAN HAGGARD

administered prices

The thesis that prices are administered was initially presented in the influential *Modern Corporation and Private Property* (1932), by Adolph Berle and Gardiner Means. These authors argued that, for many firms, the final product price reflects an administrative decision internal to the firm and not external market forces. This characterization of the thesis, along with Means' subsequent statements, makes it clear that the thesis presumes corporate MARKET POWER to be a widespread phenomenon.

The view that many industries are populated with firms holding power over price is somewhat controversial. If this point is conceded, however, then the remaining operative part of the administered price thesis is the conjecture that administered prices are less responsive to demand fluctuations than are prices set competitively. In competitive markets, demand fluctuations can translate rapidly into price movements precisely because prices are beyond any firm's power to control. By contrast, when prices are administered or set, they will not

change until someone *resets* them. Moreover, a firm may not reset its price if (1) it faces a kinked demand curve, (2) there are costs associated with price changes or (3) that price reflects a cooperative agreement among oligopolists. Hence, the price response to a given size demand shock is predicted to be slower and/or of smaller magnitude when firms have market power. Yet while the foregoing intuition is clear, one should note that even competitive markets may exhibit price 'stickiness' as a result of signal extraction problems, when queuing is an efficient rationing mechanism or when delivery lags are used to capture preferences for time of consumption.

The administered price thesis is directly relevant to KEYNESIAN ECONOMICS, in which sticky prices play a central role. Partly for this reason, the thesis has been subjected to numerous empirical tests. So far, the results have been inconclusive. Findings can change greatly depending on whether one uses list or transactions prices, focuses on durable goods or non-durable goods, assumes a linear or non-linear relationship, or includes sources of price rigidity other than market power (such as demand uncertainty). Given the variety of outcomes implied by modern models of STRATEGIC INTERACTION, the empirical regularities that the administered price thesis implies are not likely to be established soon.

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DANIEL J. RICHARDS

advanced capitalism

'Advanced capitalism' describes the countries sharing a high level of economic development, capitalist property relations (markets in labour and capital) and political institutions that channel organized social conflicts between representatives of labour and business. In comparative political economy, the countries of Western Europe, North America, Australia, New Zealand and Japan are often taken as being 'advanced capitalist' countries.

Taken literally, advanced capitalism evokes only a narrow set of economic conditions. 'Advanced' refers to a level of economic development. In contrast to the DEVELOPING COUNTRIES of, say, Africa or Latin America, the advanced capitalist countries share a history of early industrialization and high current levels of economic output and productivity. 'Capitalism' describes the market allocation of capital and labour (see CAPITALISM). Unlike the old state socialist countries of Eastern Europe (see STATE SOCIALISM), most economic activity in advanced capitalism originates in the private sector and most households secure their livelihood on the labour market.

Although these economic conditions are central to any definition of advanced capitalism, current usage in comparative politics also underlines the significance of three related political institutions. First, multiparty parliamentary democracy has been a distinctive feature of the wealthy market economies. Thus,

advantages of backwardness

the advanced capitalist countries have experienced political democracy continuously since World War II. Second, industrial relations (IR) institutions have come to exert a significant regulatory influence on contemporary labour markets. As a result, collective agreements regulate the wages and working conditions of the vast majority of workers in Western Europe. Third, the state in advanced capitalism has taken an active role in economic redistribution and economic management through social spending. Consequently, all advanced capitalist countries currently devote between a sixth and a third of GROSS DOMESTIC PRODUCT (GDP) to social expenditure.

For research in comparative political economy, the link between the economic and political conditions of advanced capitalism is provided by the idea that the main social conflict in capitalist societies is rooted in the conflicting interests of capital and labour. Political democracy in advanced capitalism is chiefly characterized as a contest between the social democratic policies of labour parties representing the working class (see CLASS, WORKING) and the conservative parties representing the interests of business. Labour relations pit TRADE UNIONS against employer associations. The WELFARE STATE is an instrument of redistribution, reducing the economic insecurity of workers.

The term 'advanced capitalism' came into common usage in the 1970s and has been widely applied in comparative research on the welfare state, labour movements and national economic performance. Principally a descriptive device, 'advanced capitalism' is used as a shorthand reference to the wealthy market economies of Western Europe and the Pacific region. In empirical research, advanced capitalism is typically represented by the countries of the ORGANISATION FOR ECONOMIC CO-OPERATION AND DEVELOPMENT (OECD). Synonyms that convey different shades of meaning – de-emphasizing the political conflict between business and labour or the importance of economic development – include 'the capitalist democracies', 'the industrialized democracies' or 'advanced market economies'.

While the theoretical implications of each term are slightly different, they are generally descriptively identical, referring to a common set of affluent capitalist countries.

The term 'advanced capitalism' can probably be traced to LENIN, who developed the idea that capitalist societies passed through different developmental stages. Writing on IMPERIALISM in 1916, Lenin argued that 'there are monopolist capitalist combines in all advanced capitalist countries' (Lenin, 1987: 215). This account, emphasizing the economic conditions of MONOPOLY and industrial concentration was later elaborated in BARAN and Sweezy's Marxist analyses of MONOPOLY CAPITALISM. Contrasting with the economic outlook of Marxist theory, political institutions were seen as central features of the wealthy capitalist societies in the socialist revisionism and liberal works of writers like John Strachey on 'contemporary capitalism' and JOHN KENNETH GALBRAITH on the 'affluent society'. These writers' concern for the ameliorative effects of political institutions on economic markets remains a strong theme in the comparative political research on advanced capitalism.

See also:

corporatism; disorganized capitalism; industrial revolution; social democratic parties

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BRUCE WESTERN

advantages of backwardness

Although the concept of 'economic backwardness' owes its origins to the mid-nineteenth century political economy of JOHN STUART MILL, it is in the essays of the Russian economic historian ALEXANDER GERSCHENKRON that the modern thesis of 'relative economic backwardness' has been developed.

Gerschenkron's thesis has focused on the timing of the process of industrialization and, in particular, on the specific economic conditions which obtained at the time when various national economies commenced what he terms their 'great spurt' of industrialization. Gerschenkron's contention is that the more delayed the industrialization of an economy, the more explosive would be its 'great spurt, and the more likely it would be that its industrialization would proceed under some organized direction' through an activist role for the state (Gerschenkron, 1966: 44). Furthermore, the more relatively backward an economy, the more likely that not only 'ideologies of delayed industrialization would develop to challenge anti-industrial vested interests' but also 'universal' investment banks, combining investment and commercial banking, would be established to accelerate the 'spurt' of industrialization (ibid.: 44).

See also:

developmental state; late industrialization

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SIMON LEE

advertising

'Advertising' is a paid form of communication carried by mass media, directed to people the advertiser wishes to influence or persuade – namely, the 'prospects' or potential consumers. The word may also refer to the profession of planning, creating and producing advertisements.

Originating in the fifteenth century from the French word *advertir*, its etymology suggests that, at its inception, it simply referred to the act of announcing the availability of merchan-

dise for sale. It may be said that modern advertising started with the invention of printing and reached its zenith during the television era. The newspapers of seventeenth-century London and Paris carried advertisements. The first advertising agencies were started, on a commission basis from the newspapers, in the United States in the second half of the nineteenth century. Although most advertising involves the selling of goods and services, it may be effectively used to promote ideas: social, religious, political and so on. Together with public relations and sales promotion, advertising is the main task of people related to the promotional mix of a business-marketing strategy, which also steers endeavours in product, pricing and distribution tactics. At the end of the twentieth century, the world of advertising revolved around a tripod of advertisers, advertising agencies and the mass media; however, at the onset of the twenty-first century, deep changes brought about by new communications technology (such as the world wide web) may affect the nature of advertising, as well as the predominance of the large international agencies that dominated the business since the 1930s.

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J. ROBERTO WHITAKER-PENTEADO

African, Caribbean and Pacific Group (ACP)

The African, Caribbean and Pacific Group (ACP) are co-signatories and beneficiaries of the LOMÉ CONVENTIONS. The ACP was legally constituted by the Georgetown Agreement on 6 June 1975, four months after the signing of the first Lomé Convention. ACP membership has grown from forty-six in 1975 to seventy-one

African, Caribbean and Pacific Group (ACP)

in 1998, including all of SUB-SAHARAN AFRICA, fifteen Caribbean and eight Pacific states.

The ACP embodies its own institutional framework, comprising:

- 1 a Council of Ministers which is the highest decision-making forum of the ACP and which negotiates and monitors the implementation of the Convention;
- 2 the Committee of Ambassadors, which is composed of all ACP ambassadors accredited to the EUROPEAN UNION (EU), and which sits and acts on behalf of the Council of Ministers when that council is not in session;
- 3 the General Secretariat, which is the executive body of the ACP, and which services and is responsible to the Committee of Ambassadors and the Council of Ministers.

In addition, there are:

- 4 the joint Council of Ministers, which defines the parameters of the Convention and is the apex of the Lomé institutions;
- 5 the joint Committee of Ambassadors, which monitors ACP-EU cooperation in Brussels;
- 6 the ACP EU Joint Assembly, made up of members of the parliaments of the EU and the ACP, which is a consultative body and an arena for joint discussion of aspects of the Lomé Conventions.

Although the ACP Group is specific to the Lomé Conventions, it grew out of earlier arrangements with the EU and with member-states. In particular, its origins can be traced to the Yaoundé Conventions (1963–75) which linked eighteen African states and Madagascar to the EU. When the EU expanded in 1975, the former British overseas countries and territories joined these to form the ACP in the negotiations for the first Lomé Convention.

In 1975, when the Lomé Conventions were created, the ACP was said to occupy the apex of a pyramid of preferences granted by the EU to the DEVELOPING COUNTRIES. This included non-reciprocal preferential access for many traditional exports, along with guaranteed markets for some exports, financial AID and

stabilization funds for loss of earnings from primary commodity exports. The ACP, led by Nigeria in particular, played a significant role in negotiating these preferences by managing to span their diverse interests and present the EU with a common negotiating position. This was a significant achievement at the time, as most of the ACP had only recently gained political independence. The EU was willing to make such concessions because they were keen to secure supplies of raw materials in the aftermath of the oil crisis.

However, the EU has subsequently expanded its development cooperation with other groups of states, in particular in the Mediterranean and Eastern Europe, with which it now has more comprehensive agreements. This expansion of cooperation agreements, along with the enlargement of the ACP has diluted their original preferential margins and challenged the ACP's place at the top of the pyramid of preferences.

The fourth Lomé Convention expired in 2000. A long process of thinking about the future of ACP-EU relations is underway. The EU raised the possibility of the break-up of the ACP in its Green Paper on the future of ACP-EU cooperation. Subsequent discussion papers have put forward suggestions for the creation of regional agreements with each subregion of the ACP.

The ACP has become increasingly diverse in terms of economic indicators, political systems and, consequently, interests. The ACP member-nations are also geographically dispersed. Nevertheless, the ACP members are keen to remain as a group, seeing strength in numbers against a powerful EU, sharing some economic factors and valuing the benefits which twenty-five years of cooperation have so far brought them. In November 1997, the ACP's Libreville Declaration called for a review of the role of the ACP and the ACP-EU institutions with a view to making them more effective, including acting as a politically cohesive force in the United Nations (UN) and the World Trade Organization (WTO). The declaration also resolved 'to strengthen the unity and solidarity

of the Group and to retain it as a geographical entity' (ACP, 1997).

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ANNA K. DICKSON

African Development Bank (AfDB)

Of the major regional development banks only the AfDB was formed without the inclusion of non-regional countries. The AfDB began operations in 1966 as a purely African institution with contributions coming only from African governments. Its headquarters are in Abidjan, Ivory Coast. The AfDB, in desperate need of capital, agreed in the late 1970s to allow non-regional countries membership and in the early 1980s non-regional members joined. For the first time, non-African donors had a direct voice in AfDB decision-making. Yet the net effect of the addition of non-regional members on the distribution of voting weight was discounted because, in order to maintain a regional look, two-thirds of votes are vested in regional members, decreasing the potential influence of non-regional members. Moreover, twelve of the eighteen members of its Board of Directors are from regional members. Members of the AfDB have 625 base votes and a single vote for each share of capital they subscribe. As is the case in other RDBs,

the staff, president and its Board of Directors conduct day-to-day operations.

JONATHAN R. STRAND

African Development Fund (AfDF)

The African Development Fund (AfDF) was established by the AFRICAN DEVELOPMENT BANK (AfDB) in November 1972 and commenced operations in August 1974. The AfDF provides DEVELOPMENT loans on concessional terms to the AfDB's poorer African member-countries. The interest-free loans are subject to a commitment fee of 0.50 per cent, a service charge of 0.75 per cent per annum and a repayment period of fifty years. The AfDF consists of all fifty-three regional members of the AfDB and twenty-five non-regional members. The non-regional members replenish the AfDF every three years.

J. ANDREW GRANT

Agenda 2000

Agenda 2000 for a Stronger and Wider Union is a medium-term plan for action of the EUROPEAN UNION (EU) for the period 2000–6. It was presented by the European Commission in 1997, with the objective of providing a blueprint for the reform of the EU in order to prepare it for eastern enlargement under the expectation that a number of economies in transition and one market economy (Cyprus) will join the organization. *Agenda 2000* refers to major challenges as the candidate transition economies have, on average, a much lower GROSS DOMESTIC PRODUCT (GDP) per capita (around one-third) than those economies already in the EU and two to three times higher relative contribution of agriculture to the GDP than is the case with the rest of the EU (2.4 per cent in 1997). Prior to the eastern enlargement, the EU has to reform its COMMON

AGRICULTURAL POLICY (CAP) and its budget. *Agenda 2000* includes a decision to keep the limit for spending for all EU activities at the level of 1.27 per cent of the total GDP of the fifteen member-countries. This limit is combined with strict constraints on national public expenditure that are related to ECONOMIC AND MONETARY UNION (EMU). *Agenda 2000* earmarked €45 billion for the period 2000–6 (a kind of mini-MARSHALL PLAN) as the pre-accession aid to the acceding countries. It also states that the application of the EU environmental standards in the acceding transition economies is the major challenge, requiring huge investment. In addition, *Agenda 2000* is firmly opposed to allowing ‘derogations’ (opt-outs) from the *ACQUIS COMMUNAUTAIRE* to any of the acceding countries. This may create additional barriers to entry and prevent the new members from exercising their right to participate fully in the EU decision-making process and from enjoying benefits of full membership of the EU. In addition, the EU will have to reform its institutions and decision-making procedures in order to accommodate enlarged membership.

See also:

European Union, eastern enlargement of the

MIROSLAV N. JOVANOVIĆ

agent–structure relations

Agent–structure relations pose challenging questions about how to conceive and study society. These questions provoke debates over the foundations of theories used to explore international political economy (IPE). Attention to agent–structure relations extends the foundations of IPE beyond political science and international relations (IR) to social science generally, deepens those foundations in social theory, opens IPE to wider philosophical and theoretical debates, and sparks controversy concerning those debates.

KARL MARX illustrates agent–structure rela-

tions: ‘men make history, but they do not make it under circumstances chosen by themselves’. Agents make choices that materially affect the world, yet social contexts or structural conditions beyond their control set the terms by which agents engage with the world. Structures include kinship patterns, culture, law, the distribution of wealth and power, and characteristics of the political system and capitalism. Agents include individuals and groups, such as organizations, governments and firms. Fundamental questions arise: How are agents and structures related? Do agents create social structures? Do social structures shape agents’ identities and interests?

The ‘agent–structure problem’ arose in IPE in the MARXIAN ECONOMICS literature of the 1970s. Scholars disputed whether capitalist structures shape history by shaping individuals’ behaviour or whether individuals affect history and society under any circumstances. In 1987, Alexander Wendt revived the agent structure problem. He argued that agents and structures simultaneously ‘co-constitute’ each other in a continuous process called STRUCTURATION. Individual agents only marginally alter the material and social world, yet the cumulative choices of all agents form broad patterns which reinforce some relationships and erode others, thereby constituting social structures. Simultaneously, structural conditions shape agents’ identities, mould interests and create (dis)incentives to make some choices.

Attention to the agent–structure problem responds to one-sided emphasis in the 1970s and 1980s on systemic, structural IPE theories (see STRUCTURAL REALISM; WORLD-SYSTEMS THEORY) or to prominent state-centred, agent-oriented theories. Agent–structure questions introduce fundamental social theory debates to IPE. Several arise in exchanges between Wendt and co-authors Martin Hollis and Steve Smith in issues of *Review of International Studies* (1991–4).

Concerning ontology, the world comprises processes which co-constitute agents and structures. This insight challenges the positivist attention to things in traditional social science (see POSITIVISM), thereby opening IPE to

alternative premises, including POST-MODERNISM and POST-STRUCTURALISM.

Concerning epistemology the study of how we know – agent–structure relations raise an important question: Is it more valuable to explain the world or to understand it? Concerning methodology, the interesting issue is which methods are most apt for the study of social relations: For which questions is objective, positivist empiricism superior to (inter-)subjective, interpretative approaches?

A final question remains: How are agents and structures related? Since structuration is ambiguous, scholars developed social construction or constructivism, which dominates IPE scholarship in the 1990s. Modernist, norm-oriented constructivism, the most prominent version, argues that ideas link agents and structures. In contrast, Nicholas Onuf argues that rules are the means of social construction, and so function as the linking mechanism.

Future IPE research will extend these debates as it seeks to promote empirical research on constructivist premises.

See also:

determinism; metatheory; structuralism

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KURT BURCH

agglomeration economies

The benefits of agglomeration are derived from the spatial concentration of linked economic activities, usually in urban places: close proximity to both suppliers and customers assists in reducing the costs of production and distribution, especially in conditions of information uncertainty; access to a range of business services facilitates management; firms can enjoy the external economies of purchasing inputs from specialist suppliers. In addition, labour markets in locations with concentrations of similar activities are more likely to offer employers a choice of workers with the needed skills, whose development had been promoted collectively through, for example, educational facilities.

These benefits were a major component of theories of industrial urbanization, with particular reference to nineteenth-century Europe and North America. Companies were attracted to the ECONOMIES OF SCALE and external economies available in major urban areas – including the infrastructural benefits of position on major transport and communications networks – rather than to relatively isolated

locations where many of those benefits – including basic training for employees – would have to be ‘internalized’ (probably at greater cost). The large urban industrial conurbations thus created then became self-sustaining growth machines, being centres for innovation and the creation of new businesses.

At the height of Fordism, the VERTICAL and HORIZONTAL INTEGRATION of firms eroded the role of agglomeration economies somewhat in certain economic sectors, most of them in manufacturing, but the subsequent growth of FLEXIBLE ACCUMULATION has seen their importance revived, with the increased volume of outsourcing and subcontracting by small and medium-sized enterprises and the growth of ‘just-in-time’ production methods, whereby individual companies contract for very constrained delivery timetables in order to minimize stock-holding. This has led to a slowdown in the process of counter-urbanization (whereby large cities declined and economic activities were increasingly transferred to smaller places) and renewed the process of urbanization. Nevertheless, modern communications technologies have reduced the need for spatial proximity of many linked activities and have stimulated the growth of ‘back office’ functions (which need no contact between provider and customer) in relatively remote locations where labour is comparatively cheap and flexible. Agglomeration economies remain important for some economic activities, but by no means all.

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RON JOHNSTON

agribusiness

The production of food products becomes ‘agribusiness’ when its regulating purpose is

not food for people’s needs, but returns on capital invested. Agribusiness can be distinguished from such traditional forms of food production as sustenance agriculture and family farm production, although the latter may assume either a sustenance or agribusiness form. The distinguishing methods of agribusiness are large-scale mono-crop farming, intensive use of chemical inputs, mechanized ploughing and harvesting, increasing devotion of grain, fish and dairy produce to red-meat production, and commodities geared to mass and export markets. Because of the extensive soil, environmental and health damages caused by its methodical elimination of biodiversity, abolition of crop rotation and fallow periods, multiple toxic effluents, run-offs and residues of petrochemical and genetically engineered inputs, and the massive scale of these operations, a growing movement towards organic, humane and ecologically sensitive farming has developed. The family farm (outside Europe and Japan where it has been protected by public policy), however, has increasingly been displaced by or converted to agribusiness methods.

Systematic elimination of sustenance farming has been the most far-reaching social effect of agribusiness – a global and often genocidal pattern which followed upon and accompanied agribusiness occupation of lands by ENCLOSURES of commons from the fifteenth century to the nineteenth in Britain and Europe (and earlier in China). After European occupation of indigenous lands from the Americas through Africa to Asia and the rise of plantation production by colonizers and their heirs, agribusiness increasingly depended less on occupying force than on lower per-unit costs of production for its replacement of alternative forms of farming and extension of the appropriation of soil resources. The global advance of agribusiness in the recent era has also depended on new kinds of state intervention. From the 1960s to the 1980s, for example, agribusiness advanced through government-subsidized export to THIRD WORLD countries of the GREEN REVOLUTION, which depended on labour-replacing mechanization, manufactured

hybrid seeds, intensive use of fertilizers and pesticides, and concentrated access to local water resources through the use of huge dams – all but the last manufactured and sold by the transnational agribusiness corporations themselves. From the 1980s on, agribusiness advanced again through transnational trade agreements and INTERNATIONAL MONETARY FUND (IMF) loan directives, which opened national borders across the globe to cheaper and government-subsidized imports from industrialized farms, and which instituted INTELLECTUAL PROPERTY RIGHTS (IPRs) over genetically modified seeds and organisms owned by transnational corporations (TNCs) (also subsidized in their development by government-sponsored ‘partnerships’ with public universities). Economic appropriation of sustenance agricultural land was in these ways complemented by increasing commodification and patenting of all the inputs required in food production – including non-reproducing or ‘suicide’ seeds to ensure continuous payment for seeds by subsistence farmers. The overall outcome of these historic trends for the sustenance farming majority of the Third World has been continuous uprooting from the land, systemic poverty and indebtedness (see SYSTEMIC RISK), increased exposure to famine and from 1917 to the present – recurrent revolutionary upsurges of resistance from landless and subsistence farmers.

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JOHN McMURTRY
TERISA E. TURNER

agricultural trade

Agriculture was not an integral part of the post-war liberalizing world trade regime. It was exempted by various provisions of the GEN-

ERAL AGREEMENT ON TARIFFS AND TRADE (GATT) and protected from foreign competition in most industrialized countries, including the world's foremost agricultural traders. The United States obtained a waiver from most of its GATT obligations concerning agriculture in 1955; in the 1960s the European Community (EC) enacted the COMMON AGRICULTURAL POLICY (CAP), which supported European commodity prices above world levels and insulated European producers from competition within the EC's common market. Attempts by the United States to liberalize agricultural trade during the KENNEDY and TOKYO ROUNDS of GATT failed, opposed by the EC, Japan and other countries committed to protecting their agricultural sectors.

The post-war pattern of government intervention in agricultural markets has been eroded in the late twentieth century. Agricultural trade is becoming freer and more subject to the discipline of international rules. Agricultural trade liberalization can be traced to the integration of regional and global agri-food markets, as cross-border trade in commodities and processed food products has accelerated since 1975. The total value of international trade in agri-food products increased nearly six-fold between 1972 and 1993. World agri-food trade grew from US\$209 billion to US\$463 billion between 1985 and 1996. Trade in higher-valued processed food products has increased more than trade in lower-value bulk commodities.

The growth in cross-border trade and investment is most pronounced within regions – like North America and Europe – where multinational firms engage in intra-industry trade. Regional market integration has been both a stimulus and response to regional trade agreements: the NORTH AMERICAN FREE TRADE AGREEMENT (NAFTA), MERCOSUR, the Andean Pact (see ANDEAN COMMON MARKET), the CARIBBEAN COMMUNITY (CARICOM) and the Closer Economic Relations Trade Agreement between Australia and New Zealand all liberalize agri-food markets. Cross-regional market integration has exacerbated agri-food trade conflicts and heightened pressure to liberalize

agri-food markets on an international basis. These pressures reached a zenith in the mid-1980s when the United States subsidized its grain and dairy product exports extensively in a bid to recapture export markets lost to the EC. The ensuing trade conflicts and the negative repercussions for other agri-food export-dependent countries precipitated the URUGUAY ROUND of GATT (1986–93). These protracted negotiations witnessed a sharp philosophical divergence between the Cairns Group of agricultural exporters and the United States, who both argued for market liberalization, and the EC, Japan and other food-importing countries, which supported state assistance and market regulation. The resulting multilateral Agreement on Agriculture, implemented as part of the WORLD TRADE ORGANIZATION (WTO) in 1995, restored order to the agri-food trading system by incorporating agriculture in a new liberal international trade agreement.

The WTO Agreement on Agriculture does not introduce free trade in raw commodities and processed products, and (in the short term at least) resulted in higher average rates of border protection for certain sensitive commodities. However, the agreement disciplines member-countries' use of not only tariff and non-tariff border measures but also domestic policies, including export subsidies and internal policies and practices that distort trade. The parallel Agreement on Sanitary and Phytosanitary Measures (SPS Agreement) limits countries' ability to use food safety measures to restrict trade. Both the Agreement on Agriculture and the SPS Agreement are enforced by the WTO, whose dispute settlement procedures and enhanced authority ensure a timely resolution of agri-food trade conflicts.

In conjunction with domestic fiscal pressures and political priorities, the WTO Agreement on Agriculture and regional trade agreements are liberalizing agricultural markets in the world's most important agricultural nations. They have locked-in reforms that were implemented before and during the Uruguay Round, and promoted further policy changes of a market liberalization nature.

Pressures to liberalize agricultural trade policies have continued into the new century, focusing on establishing multilateral rules to recognize the linkages between agricultural trade, investment, competition and state trading. Greater transparency of monopoly export and import state-trading enterprises, improved market access through lowered agri-food tariffs and reducing export subsidies are issues for discussion during the WTO agricultural trade negotiations that were initiated in 2000. Nonetheless, full-scale liberalization will be resisted, owing to individual countries' concerns about food security and the stability of their agri-food sector.

The liberalization of agricultural markets eases – but does not erase – conflict in the agricultural trading system. Disputes continue to erupt over NON-TARIFF BARRIERS (NTBs), including food safety and agro-biotechnology regulation. These disputes centre on issues like the use of growth hormones in meat, and the licensing and labelling of genetically modified organisms. Disparate consumer preferences across countries with respect to food safety standards and genetically engineered foodstuffs provide ample grist for the mill of trade disputes and have precipitated a new era of agricultural trade conflicts, one characterized by a broader public debate than has marked agricultural trade skirmishes in the past and one which engages cultural values as much as the economic interests of the agri-food sector.

See also:

agriculture and development

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GRACE SKOGSTAD

agriculture and development

Ever since the time of DAVID RICARDO in the early 1800s, one line of DEVELOPMENT theory has emphasized that agricultural progress contributes to the support of greater productivity throughout the economy. Ricardo viewed the problem of DIMINISHING RETURNS in agriculture as crucial. He believed that a limitation on the growth of agricultural output set the upper limit to the growth of the non-agricultural sector and to capital formation for economic expansion.

Despite Ricardo's insights, post-war students of economic development long considered industry, not agriculture, as the engine of growth. In contrast to industry, agriculture was believed to be unresponsive to economic incentives and did not lend itself to technical change. Thus policy-makers believed that promoting industry at the expense of agriculture would sacrifice little in output – or so went the conventional wisdom in the 1950s, 1960s and 1970s.

There was logic to this conventional theory. Explicit agricultural taxes (such as export taxes) and implicit taxes (such as marketing boards paying farmers less than market prices) were easy to administer and extremely attractive in countries with a thin tax-base. In addition, shifting scarce resources to industry was thought justified by agriculture's declining TERMS OF TRADE – a pound of agricultural exports was buying increasingly less than a pound of industrial imports – and by the rising

of protection of agriculture in industrial countries. Policy-makers thus biased incentives against agriculture, directly through sectoral policies and indirectly through industrial protection and other policies.

By the 1980s it was becoming apparent that agriculture was profoundly influenced by events external to the sector – INDUSTRIAL POLICY and exchange rates (see EXCHANGE RATE) – which in turn affected INVESTMENT, growth and income in agriculture. It also became apparent that biasing incentives against agriculture was far more harmful to output than surmised earlier. A stagnant agricultural sector was the one common factor linking most of the growth disasters in developing countries of the 1950s, 1960s and 1970s.

Now it is customary to stress (Johnston and Mellor, 1961) four ways in which greater agricultural productivity and output contribute to an economy's development: (1) by supplying foodstuffs and raw materials to other expanding sectors in the economy; (2) by providing an 'indivisible surplus' of savings and taxes to support investment in another expanding sector; (3) by selling for cash a 'marketable surplus' that will raise the demand of the rural population for products of other expanding sectors, and (4) by relaxing the foreign exchange constraint by earning foreign exchange through exports or by saving foreign exchange through import substitution.

Simon Kuznets (1965) summarizes these contributions as the 'market contribution' and the 'factor contribution'. In the market contribution, agriculture contributes to growth by (1) purchasing some production items from other sectors at home or abroad, and (2) selling some of its product not only to pay for the purchases of other sectors but also to purchase consumer goods from other sectors. The factor contribution occurs when there is a transfer or loan of resources from agriculture to other sectors. Thus, if agriculture itself grows, it makes a product contribution: if it trades with others, it renders a market contribution; if it transfers resources to other sectors, it makes a factor contribution.

Here, the development process is viewed as

one of structural transformation with industrial development cut short by lack of agricultural progress. In Ricardian terms, if food supplies to the modern sector do not keep up with the modern sector's demand for labour, the modern sector will have to consume a larger share of its output in feeding its labour force and this will leave a smaller surplus for capital accumulation.

In recent years, the emphasis on agriculture's contribution to economic development has been extended (Singh and Tabatabai, 1992) beyond its value in sustaining expansion elsewhere in the non-agricultural sector. In addition to that contribution, agricultural growth is seen as contributing to development through its own absorption of labour and its own increase of real income among the rural poverty target-groups of the small farmers and the landless labourers. The widely expressed view now is that the root of many employment problems lies in the fact that modern economic activity is not being diffused to the countryside.

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ROBERT LOONEY

aid

'Aid' is the transfer of goods or services on a concessionary basis to DEVELOPING COUNTRIES for development purposes. Aid flows grew rapidly in the post-war period until the late 1970s, since when they have experienced erratic growth and occasional stagnation.

Many question aid's effectiveness, especially in relation to the central objective of poverty alleviation; others defend the record and point to the constraints imposed on aid by donors' use of aid funds for their own commercial and political ends. In the mid-1990s, as private capital flows to developing countries are once again growing, some argue that we have come to 'the end of aid', but this view seems premature given the number of low-income countries with limited access to international capital markets.

The most usual definition of aid uses the DEVELOPMENT ASSISTANCE COMMITTEE (DAC) criteria (official, for developmental purposes, concessional and to a developing country) for qualification as OFFICIAL DEVELOPMENT ASSISTANCE (ODA). Aid data, using this definition, have been available since the 1960s (previously donors included what they wished, which included military assistance and supplier's credits). These data show that ODA as a percentage of donor GROSS NATIONAL PRODUCT (GNP) was 0.4 to 0.5 per cent in the 1960s, but had declined to 0.3 to 0.4 per cent by the early 1970s and stayed at that level for two decades. However, in the 1990s the percentage has fallen again, reaching its lowest ever level of 0.25 in 1996 (the most recent year available at the time of writing). Donors are thus moving away from, rather than towards, the target of 0.7 per cent of GNP. In nominal terms, the aid budget has risen from US\$7 billion at the start of the 1970s to US\$50-60 billion in the 1990s, representing growth of one-third in real terms during the 1970s and another 25 per cent over the 1980s, but having been relatively stagnant in the 1990s. Moreover, the rapid growth of private flows in recent years has brought the share of ODA in total resource flows to developing countries down from two-thirds in the late 1980s to only one-fifth in the mid-1990s. But some countries, especially in SUB-SAHARAN AFRICA, have little access to international capital markets and so remain reliant on aid.

Aid may reach the recipient country by one of three channels: (1) bilateral aid (see AID, BILATERAL), (2) multilateral aid (see AID, MULTI-

LATERAL) and (3) NON-GOVERNMENTAL ORGANIZATION (NGO) assistance (funds raised by NGOs themselves do not count as ODA, but funds channelled through them by official agencies do; the former is only around 0.03 per cent of donor GNP for DAC as a whole). Direct bilateral assistance remains the most important channel: multilateral aid accounts for around 30 per cent of ODA and bilateral agencies only put around 3 per cent of their aid through NGOs (this figure being just over 10 per cent for only two donors, the Netherlands and Switzerland).

In addition to aid volume, the DAC monitors other aspects of aid quality, notably the terms of aid, geographical allocation and the share of tied aid (see AID, TIED). Aid quality is not, in general, related to the impact of aid, about which we know less than may be expected. The concessionality of aid has improved over time as a greater share of ODA is grant aid, which has grown from 60 per cent in the early 1970s to over 75 per cent for bilateral ODA: accordingly the grant element (a measure of concessionality) of aid has risen from 80 per cent in the 1970s to 90 per cent in the 1990s. The majority of aid goes to low-income countries, although the actual pattern of bilateral aid can easily be shown to be related to a donor's political and strategic ties, as well as commercial considerations. Related to the latter is the relative lack of success in reducing aid-tying, which is in any case more widespread in practice than the data suggest.

What aid has achieved depends on how its purpose is viewed. Critics of aid from a DEPENDENCY THEORY perspective see it as an instrument for entrapping developing countries in the international capitalist system and so furthering their exploitation. Proponents of this position would point out how aid opens economies up to the outside world by financing infrastructure projects and requiring LIBERALIZATION of recipient economies. Until recently, they could also point to how blatantly aid was used as a weapon in the COLD WAR, with scant regard for the authoritarian nature of many beneficiary regimes. From this point of view,

aid may provide the occasional palliative, but its overall impact will be to increase poverty by the subordination of developing countries in the global economy.

A rather different critique comes from writers on the Right, who oppose most forms of government intervention. Since aid mostly flows to governments, it of necessity reinforces their position, allowing them to ignore or suppress private-sector initiatives. These authors may also emphasize how aid can distort relative prices, of which the best-known example is the disincentive effect of food aid (food aid reduces domestic agricultural prices, thus discouraging production). A point here, which deserves more recognition than it has received to date, is that donors undermine their own attempts to support democratic government by driving a wedge between the recipient government and population when aid funds are more sensitive to government policy than are tax revenues or even voter preferences.

Between these two critical perspectives is the 'aid effectiveness' literature, which does not reject the underlying premise of aid but may question aid's impact. Analysis of aid effectiveness is readily divided into the macro-economic literature and micro-level analyses of specific interventions. While aid agencies have a number of objectives – which may generally be summarized as poverty reduction, sustainable economic growth, gender equality and good governance – aid effectiveness is usually measured against economic objectives, with the macro-economic literature looking at aid's impact on growth and micro-economic studies applying cost-benefit analysis.

The traditional model of aid's impact on growth is the TWO-GAP MODEL which is built around the HARROD-DOMAR GROWTH MODEL. In this model, growth depends solely on the investment rate which, in turn, depends on savings and imports. Aid can fill either the savings gap (supplement domestic savings) or trade gap (supplement export earnings). According to this model, an aid inflow of 10 per cent of GNP should add around 2–3 per cent to a country's growth rate. But many countries receiving aid, even in excess of this amount,

have often actually had no growth at all, and no correlation can be found between aid and growth (a finding further supported in many multiple regression studies). The macro-economic literature seeks to explain this result by arguing that aid may displace domestic savings (in aggregate or focusing on fiscal behaviour – that is, fiscal savings) or exports (aid as a cause of the DUTCH DISEASE, by which aid inflows cause a real EXCHANGE RATE appreciation and so discourage exports). But aid can affect macro-economic performance not only by the inflow of foreign exchange, but also by improving the efficiency of domestic resources. Traditionally, this role was played by technical assistance, but since the 1980s most donors have made a part of their aid (programme aid) conditional on the implementation of a STRUCTURAL ADJUSTMENT PROGRAMME (SAP) – that is, market-based economic reforms. It is argued in some studies that aid is effective when given to a country with ‘good policies’, but may actually be harmful in others, as it helps postpone necessary reform. Others argue that it is the structural adjustment policies themselves that are harmful.

Moving beyond this aggregate level, aid effectiveness is most usefully discussed in the context of a functional classification of the types of aid. The main categories are (1) project aid – the traditional type of aid to finance a discrete investment project (historically donors paid only the import content of investment, but now they are more willing to pay local and recurrent expenditures); (2) technical assistance – skills transfer by foreign experts or training, which may be either project-related or free-standing; (3) commodity aid – formerly mostly food aid, but in the 1990s untied import support has grown in importance; (4) programme aid – import support and debt relief are collectively called ‘balance-of-payments support’, but programme aid may also include budget support, and (5) emergency assistance – a large part of which is food aid.

The extent to which donors evaluate their projects varies. The most systematic is the WORLD BANK, which finds that the vast majority have what is termed a ‘satisfactory

performance’ (requiring a rate of return of at least 10 per cent where this calculation is performed, which it is not for many projects); this percentage fell from 80 to 60 per cent in the 1980s, but has since recovered to 70 per cent, although there are some sectors which are notably poor performers, such as rural development in Africa. However, some argue that there are institutional biases in favour of satisfactory findings, so that some projects labelled ‘satisfactory’ may not appear so to others. Perhaps of most concern is the lack of attention to sustainability – that is, the continuation of project benefits after the termination of donor support. A possible reason for lack of sustainability is poor technical assistance. Reliance on long-term expatriate project workers has come under attack in recent years, but this has not been matched by any notable reduction in their numbers, nor even improved management practices (for example, lack of training on the part of donors or of proper monitoring on the part of recipients).

Food aid was the main type of non-project aid, although it is also being used for projects through Food-for-Work projects. However, the importance of food aid has diminished markedly in recent years, together with a re-emergence of emergency assistance (not all of which is food aid). Financial programme aid (that is, foreign exchange given to the government but not tied to a specific activity) became important in the 1980s as donors put conditionalities on their aid. There has been some diminution of this in the 1980s, though debt relief remains important. This form of assistance is moving toward Sector Investment (or Expenditure) Programmes (SIPs or SEPs), which may not be readily recognizable as programme aid from the data. The effectiveness of programme aid is linked to the effects of structural adjustment programmes and the overall macro-economic impact of aid.

The central question in analysing aid effectiveness is that of poverty reduction which, in the 1990s, has once again become central to the donor agenda, with most governments subscribing to the target of halving poverty by

2015. The most striking fact is how little is known about aid's impact on POVERTY. Project and programme design is not usually carried out in such a way as to allow proper evaluation of their impact on poverty, so evaluators rely on *ad hoc* judgements. This fact alone indicates that poverty reduction has not been a central concern and it can be said that only 10–20 per cent of aid has been used for direct poverty reduction, although agency officials would reply that all aid is poverty-reducing. Against that view, one can point to aid interventions (in particular those involving involuntary resettlement) that have been poverty-increasing.

Many people speak of 'aid fatigue', but this phenomenon has been around since at least the time of the PEARSON COMMISSION in the late 1960s. Aid is set to remain a feature of the international environment in the foreseeable future, in particular for low-income countries, although some changes may be afoot. Current concerns of donors include how aid may play a complementary or facilitating role to private flows; how a coherent framework for international relations (of which aid is just one part) may be provided, and how to reduce the ill-defined concept of aid dependence. In relation to the last of these, donors seek partnership with recipients (rather than an unequal relationship) and state that recipients should take 'ownership' of the aid programme. In practice, such moves may be prevented by political pressures on the aid programme, which are also likely to confound attempts at policy coherence.

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HOWARD WHITE

aid, bilateral

Bilateral aid is aid from one government to another, which distinguishes it from multilateral aid – aid from international bodies, such as the UNITED NATIONS (UN) (see AID, MULTILATERAL). While there are arguments in favour of multilateralism, bilateral aid persistently accounts for the majority of aid flows, largely because it enables the donor to exploit the political and commercial possibilities which are lost if multilateral channels are used.

The history of aid has seen several shifts in the relative importance of different donors, reflecting changes in global geopolitics. From the early 1950s, the United States expanded its aid programme at a time when there were few other donors. In 1956, however, Krushchev launched the Soviet aid programme and both

aid, multilateral

powers openly used aid as a weapon with which to fight the COLD WAR (a rivalry that was successfully exploited by some recipients, notably Egypt and India). The United States increasingly expressed concerns about 'burden sharing', since the benefits of safeguarding the free world (as it was put at the time) accrued to all Western countries. In response to these pressures, as well as to the calls from newly independent countries for help from former colonial powers and a humanitarian impetus in northern European countries, the 1960s saw the emergence of a number of bilateral aid programmes. The oil boom in the mid-1970s financed a growing Arab aid budget, which reached 30 per cent of total net OFFICIAL DEVELOPMENT ASSISTANCE (ODA) in the second part of the decade, but then fell back rapidly so that the share of DEVELOPMENT ASSISTANCE COMMITTEE (DAC) donors in the late 1980s was just under 70 per cent; a share it has retained in the 1990s (most of the rest is multilateral aid). In the 1990s aid from the former Soviet Union has disappeared and Japan has overtaken the United States as the largest bilateral donor.

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HOWARD WHITE

aid, multilateral

'Multilateral aid' is AID from international bodies and thus distinguished from bilateral aid (see AID, BILATERAL), which is aid from one government to another.

The main multilateral agencies are the UNITED NATIONS (UN) family (the WORLD

BANK nominally part of the UN system – and the INTERNATIONAL MONETARY FUND (IMF)), the regional development banks and the EUROPEAN UNION (EU). During the 1950s, pressure grew for a Special United Nations Fund for Economic Development (SUNFED), but donor governments were reluctant to have this body under the one-country, one-vote system, instead creating the INTERNATIONAL DEVELOPMENT ASSOCIATION (IDA) at the World Bank, where votes are proportional to capital subscriptions. Hence, the World Bank is the largest multilateral agency. The World Bank and regional multilateral development banks (MDBs) in combination account for 40 per cent of net multilateral OFFICIAL DEVELOPMENT ASSISTANCE (ODA). Since the MDBs have non-ODA windows, their share of Official Development Finance (ODF) is higher: more than 50 per cent. The UN's share of multilateral ODA has typically been 15 to 20 per cent, whereas the share of the EU has risen from around 10 per cent in the 1970s to over 25 per cent in the 1990s.

Multilateral aid is argued to be superior to bilateral aid because the former is immune to political and commercial interference. This statement is not entirely true. Donors can put political pressure on agencies – for example, the United States vetoed IDB and World Bank lending to Nicaragua in the early 1980s. Sometimes donors tie their multilateral contributions – during the 1960s US contributions to IDA could not exceed IDA procurement from US suppliers – but more generally donors apply the *juste retour* principle that multilateral procurement should be roughly proportional to contributions. A further argument for multilateralism is the benefits to aid quality that arise from increased donor coordination. A small number of specialized agencies would counter the problem of donor proliferation whereby the resources of a recipient government are consumed in aid management. However, in practice, the quality of much multilateral aid has been open to criticism and their coordinating function weak.

See also:

Development Assistance Committee (DAC)

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HOWARD WHITE

aid, tied

AID may be tied to either projects, policies or procurement. The expression 'tied aid' usually refers to the last of these, meaning the recipient must spend the funds on goods and services from the donor country. Aid is 'partially tied' if the purchase may be from a third party (usually another developing country). Under 'mixed credits' (or 'associated finance'), an aid grant is combined with a non-concessional export credit, the whole amount being tied to procurement. Aid tying is criticized for distorting project choice and design, and because goods and services procured using tied aid are more expensive than market prices. Despite persistent efforts by DEVELOPMENT ASSISTANCE COMMITTEE (DAC) to reduce aid tying, the amount of aid which is formally untied has reduced only slowly: from just under 40 per cent in the early 1970s to just under 60 per cent in the mid-1990s; in addition, official data understate the extent of tying, which is often through informal means. Defenders of the practice argue that it is legitimate to use aid simultaneously for development abroad and to create jobs at home.

See also:

aid, multilateral

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HOWARD WHITE

Airbus Consortium

The Airbus Consortium was agreed in 1969 to maintain and expand European production of civilian aircraft in the face of US competition and high aircraft-development costs. It involved Aérospatiale (France), British Aerospace, Dasa (Germany) and Construcciones Aeronauticas (Spain). Instead of pooling the subsidies given by the various countries to their aircraft industries so as to support a new integrated company, a consortium with negotiated production-sharing was chosen because of concern to protect national sovereignty and jobs. Subsidies were crucial to the success of Airbus Industrie and a source of friction with the United States, which complained of unfair competition (Europeans pointed to 'fat' defence contracts for US firms as a source of implicit subsidies). With growing sales and market share, these subsidies became less vital in the 1990s. For some this was a 'mercantilist' triumph for 'strategic trade policy' (see MERCANTILISM; STRATEGIC TRADE THEORY), shifting revenues from Boeing to Airbus while limiting both European dependence on the United States and the monopolistic power of Boeing. However, Boeing's market-share increased in the later 1990s, as did development costs. The need for an integrated Airbus company grew. It was intensified by the merger between Boeing and McDonnell-Douglas in 1997. By 1998, even Aérospatiale admitted the need for this change so as to cut costs.

See also:

competition and government policy; competition between local and foreign industries; competition, economic role of; monopolies

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DAVID LAW

alienation

'Alienation' has two main meanings. First, it can refer to the transfer of ownership of a particular object. Second, it can refer to the estrangement from or loss of one's personality or true self.

Alienation was particularly prevalent in social contract theory and the writings of GROTIUS, HOBBS and LOCKE. For Grotius, sovereign authority over oneself (which he interpreted to be a form of property right) could be alienated or transferred to another body, thus providing the justification for political authority. Hobbes uses similar terminology to express the transference of rights from the individual to an almighty sovereign in return for security. Additionally, Locke refers to the transferral or alienation of the 'executive power of the law of nature' – the right to punish those who transgress the natural law – to political society. Rousseau further uses alienation in the sense of alienating one's liberty and also in terms of giving away or selling something. In contrast to Grotius in particular, however, Rousseau thought that sovereignty could only be alienated to a community under the direction of a general will. This positive understanding of alienation was in contrast to Rousseau's criticism of the alienation experienced by individuals in society who had been corrupted from their true selves. In a society where one alienates one's rights into the collective to which one belongs, Rousseau thought that individuals could unite with others and yet be free. This influenced other thinkers, such as G.W.F. Hegel, who used alienation in both senses of the term but with particular emphasis on the estrangement from one's self and from others.

The most detailed development of the concept of alienation is to be found in the writings of KARL MARX. For Marx, alienation refers to the fact that CAPITALISM denies humanity its human essence – that is, what it means to be a human being. Alienation can take four particular forms. First, there is the alienation of workers from the products that they create, because those products belong not to the workers but to a capitalist. The workers have no control over the production process in which commodities are created because they do not own the means of production. Second, there is alienation from the productive activity itself. Work can often be boring and repetitive and not a self-fulfilling activity. This alienates individuals from the capacity to express their creativity through work. Third, there is alienation from other individuals. In the labour market in particular, and society in general, people are forced to compete against each other. This inevitably leads to alienation between people as they see each other as hostile and opposed to each other's interests. Finally, there is alienation from our species-being or from the essence of what it is that makes us human. Marx argues that the human essence is not pre-inscribed as it is for non-human animals. Through productive activity, human beings can choose what they want to do or be. In capitalism, however, humans are alienated from their capacity to determine themselves because they do not own the means of production and have to sell their labour-power in order to exist. Alienation in terms of the separateness of oneself from society or others has thus become the dominant understanding of the term since Marx.

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IAN FRASER

Alimentarius Commission

The Codex Alimentarius Commission is a food standards body linked to the UNITED NATIONS (UN), that is run jointly by the UN's FOOD AND AGRICULTURE ORGANIZATION (FAO) and WORLD HEALTH ORGANIZATION (WHO). It was set up in 1963. Its standards were voluntary. As an advisory body, it influenced developing countries wishing to set standards cheaply, off-the-shelf. This modest role was upgraded with the completion of the URUGUAY ROUND and the setting up of the WORLD TRADE ORGANIZATION (WTO): with food standards being recognized as a possible form of protectionism, dispute settlement in the WTO required a 'neutral' arbiter. This role was suited to the commission, which brings together government regulators, consumers and industry representatives. Because the influence of the big transnational food corporations outweighs that of consumer NON-GOVERNMENTAL ORGANIZATIONS (NGOs), there are fears of a future lowering of standards in some developed countries.

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DAVID LAW

Alliance for Progress

The Alliance for Progress was a package of aid measures directed by the United States towards the countries of Latin America. The underlying aim, in the wake of the Cuban Revolution, was the alleviation of social conditions perceived as fomenting revolution. The prime features were social reforms (in particular LAND REFORM), economic DEVELOPMENT and the promotion of democracy. Although there was some transfer of resources to Latin America, the package was a failure overall, due to the reluctance of many governments to institute wide-ranging reform

packages and the readiness of the United States to recognize military regimes.

STEPHEN HOBDEN

alliances, inter-firm

An 'inter-firm alliance' is an organizational structure established to govern an *incomplete contract* between *separate firms* and in which each firm has *limited control*. Because the partners remain separate firms, there is no automatic convergence in their interests and actions. As a result, to deal with unforeseen contingencies inherent in the incomplete contract, the partners need to make decisions jointly (see Gomes-Casseres, 1996).

A contract is termed incomplete when, despite the fine print, it does not specify fully what each party must do under every conceivable circumstance (Williamson, 1975; Hart and Holmström, 1987). Lawyers generally try to avoid writing incomplete contracts, because these arrangements typically end up in court or in arbitration when an unforeseen controversy arises. Even so, legal experts would be the first to recognize that many contracts are incomplete in one way or another and that 'evolving contracts' or 'relational contracts' are needed to govern such agreements; these are essentially alliances (Williamson, 1979).

For many economists, the prevalence of incomplete contracts yields the basic rationale for the existence of the firm (Coase, 1937). Market transactions work well when the parties can write complete contracts, they argue. But when this is not possible, it is usually more efficient to 'internalize' the transaction within a firm; this firm can then make optimal decisions when unforeseen circumstances arise. If such an incomplete contract is left to the market, the parties (each acting in their own best interest) are likely to haggle over how to handle the 'gaps' in the agreement. At the extreme, the very prospect of such ex post facto haggling and opportunistic behaviour might deter the parties from concluding an agreement in the first place. INTEGRATION is thus many

economists' favourite way of governing incomplete contracts.

For example, the need for heavy investments in relationship-specific assets may lead to bilateral monopolies that create incentives for opportunistic recontracting. It is often impossible or costly to write contracts that avoid this problem. Knowing this, firms are likely to decline opportunities to conduct such transactions through contracts, choosing VERTICAL INTEGRATION instead (Williamson, 1975).

An alliance is an alternative way to govern such an incomplete contract. Alliance agreements are typically open-ended and contain 'gaps' typical of incomplete contracts. In contrast to full integration, alliances use some form of joint decision-making to deal with unforeseen circumstances. Note that the designers of the alliance do not create these gaps on purpose – rather, they design the alliance to govern the incomplete agreement that stems from the nature of the business and the industry in which they are operating.

Alliances thus involve a mix of features of firms and of markets (Stinchcombe, 1990). They resemble markets in that the partners remain separate parties, driven by their own interests. Each partner thus runs some risk that the other will act opportunistically, as traders might in the open market. Alliances resemble firms in that the partners agree to coordinate their actions and participate in joint decision-making. In this sense, the partners practise mutual forbearance: they forgo short-run opportunistic actions in the interest of maintaining the relationship, which they expect will yield long-run benefits (Buckley and Casson, 1988). Like firms, alliances involve some degree of 'TRUST' between transacting parties.

Although all alliances share these basic attributes, they come in a myriad of different structural forms. These different structures affect the pattern of decision-making and the control of capabilities. Jointly owned ventures, LICENSING relationships, joint RESEARCH AND DEVELOPMENT (R&D) programmes, co-marketing programmes and partial equity investments are all alliances by this definition. The relationship between a buyer and supplier of an

intermediate product, too, may represent an alliance, provided that the contract between the two is in some substantial sense incomplete.

Alliances also differ according to the operational relationship between the partners. Some alliances represent what economists call 'vertical' relationships (that is, between suppliers and buyers) and other represent 'horizontal' relationships (that is, between companies selling the same or similar products). Some alliances combine one firm's technological capabilities with another firm's marketing organization; other alliances pool similar capabilities from different companies.

The differences between these alliance forms and motivations can be the subject for a more extensive discussion (see Kogut, 1988, on various approaches to alliances and Hennart, 1988, on the role of equity). These differences do matter for many purposes, but because the various alliance forms share many behavioural characteristics, they can often be grouped together for analytical purposes.

Regardless of the form, three conditions must obtain for an alliance to be an optimal form of organization – or what economists call 'efficient' (see EFFICIENCY). First, there must be an advantage to combining the capabilities of two or more firms. For this to occur, each firm must be unable to develop internally the capability offered by the other firm: for example, it may be constrained from doing so by its resources, its skills or lack of time. Also, the combination of capabilities must yield a total value that is greater than if the capabilities were used separately. This type of 'synergy' is common in modern businesses.

The second condition required for an efficient alliance is that it be costly or impossible to combine the capabilities through pure market transactions (that is, using complete contracts). For example, each owner may need to 'tailor' or upgrade their capability through investments or invisible efforts that are specific to the transaction: this creates a threat that one firm will hold the other 'hostage' after the investment is made and try to extract a greater share of joint profits. Complete contracts under such circumstances are costly to

negotiate, monitor and enforce, as each firm will have an incentive to cheat. The firms then have to find an alternative way to govern the incomplete contracts that result.

Complete ownership would be a way to govern such incomplete contracts. So the third and final condition for an alliance to be optimal is that a full merger between the firms must be costlier than a series of alliances as a way to govern the incomplete contracts. This condition does not occur as commonly as the other two, with the result that we often see full integration as a mechanism for combining capabilities. But when there are limits to the size and complexity of the firm (that is, when integration generates high costs) then an alliance is a more efficient solution. Alternatively, there may be regulatory or political barriers that preclude full integration and drive firms to an alliance as a 'second-best' solution (see SECOND BEST, THEORY OF).

A recent stream of research in inter-firm alliances focuses not on the bilateral governance of these relationships, but on how a series of interconnected alliances creates 'networks' (Gulati, 1998) or rival 'constellations' (Gomes-Casseres, 1996). In this latter view, alliances are seen as creating new units of competition and reshaping rivalry – instead of firm against firm, the new rivalry is one of group against group. Constellations of allied firms are thus seen as an alternative to the firm in governing a set of complementary capabilities.

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BENJAMIN GOMES-CASSERES

alternative development

'Alternative development' (closely associated with 'another development' and the 'new economics') has been mainly concerned with redefining the goals of development. The rise of alternative development in the post-1945 period is associated with the 1975 report of the Dag Hammarskjöld Foundation entitled 'What now? Another development'. This report emphasized that development should be directed at BASIC NEEDS, should be in harmony with the environment, and must be endogenous and self-reliant. Alternative development has been associated with a wide spectrum of attacks on 'orthodox' or 'mainstream' economics, with the emphasis being variously on anti-capitalism, anti-individualism, environmental destruction, male chauvinism, and the centralization of economic power and culture.

Given this wide range of concerns, it is perhaps not surprising that numerous organizations are and have been associated with alternative development and the new economics. A list of these organizations can be found in

Americanization

Appendix 2 of both *The Living Economy* and *A New World Order* (Ekins, 1986, 1992), but prominent examples are the Dag Hammarskold Foundation in Sweden, the Worldwatch Institute in Washington, the International Foundation for Development Alternatives and the International Cooperative Alliance (both in Switzerland), the World Council of Credit Unions in Madison, Wisconsin, The Other Economic Summit (TOES) in London, as well as those organizations associated with the promotion of intermediate or APPROPRIATE TECHNOLOGY.

It is also not surprising that when it comes to concrete policies, the targets are diffuse. The general emphasis is on income and wealth distribution, on the devolution of power and on environmental concerns. In general, there is support for SCHUMACHER's belief that 'small is beautiful'. Thus the policies advocated are those concerned with promoting the roles of NON-GOVERNMENTAL ORGANIZATIONS (NGOs), local authorities and small firms, and with promoting credit unions, cooperatives and community currencies.

The policies are recognized as being difficult to implement in the face of the growing GLOBALIZATION of trade, finance and production. 'Think globally, act locally' is the core slogan, but somewhat ironically it is recognized that the implementation of alternative development policies may require the support of national governments and even multilateral organizations.

Given the practical obstacles, it is fair to say that the major contribution of alternative development has been in attacking 'orthodox neo-liberal economics' (see NEO-LIBERALISM) both for its emphasis on economic growth as a prime objective of economic policy and for the way in which economic output is conventionally measured.

See also:

autonomous development; development; economic growth; Galtung, Johan; gross national product (GNP)

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CHRIS EDWARDS

Americanization

'Americanization' is the adoption of those cultural, social, political, ideological or economic characteristics usually specifically associated with the United States. Americanization has occurred both within the United States, as a process affecting immigrants and Americans of non-European descent (especially Native Americans), and externally. Americanization outside the territory of the United States has principally been a phenomenon of the twentieth century and has markedly increased in both Europe and the Asia-Pacific area since 1945. The dependence of Japan on the United States immediately after World War II, in particular, promoted very rapid Americanization. In Europe and elsewhere in the Asia-Pacific area, Americanization has predominantly been seen in the adoption of aspects of US culture, such as clothing, and of US forms of business and management practices. In Central and South America, Americanization has been especially marked in terms of religious change: the widespread transformation of traditionally Roman Catholic societies by the rapid growth of Evangelical Protestantism. These cultural and religious changes have often been attributed to the United States' control of mass media (especially television broadcasting) and to Hollywood's dominance of world film-making and distribution.

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KEN DARK

anarchy, international

In much contemporary international relations (IR) theory, 'anarchy' is taken to be a central feature of the international system. Anarchy describes the structural relationship that exists between a set of sovereign units. In an anarchic system, the constituent units refuse to acknowledge the existence of any higher authority. Anarchy is thereby seen to be the counterpart of hierarchy: together they represent the conceptual divide between international and domestic politics. Although sharing the same conception of anarchy, theorists of a neo-realist and neo-liberal (liberal institutionalist) persuasion are deeply divided about the theoretical implications (see INSTITUTIONALISM, LIBERAL; NEO-LIBERALISM; NEO-REALISM). The contemporary debate, however, is only the latest stage in a genealogy that presents a diverse and complex picture of the concept. Indeed, according to Schmidt (1998), the history of IR can be characterized in terms of a 'discourse of anarchy'.

Outside IR, anarchy is most commonly associated with the violence and disorder that often occurs as the result of the absence or disintegration of government. There is a long pedigree for this usage, although it is most frequently traced back to THOMAS HOBBS, who argued that in a state of nature (where there is no government) insecurity is chronic and pervasive. Under such conditions, he famously suggested that life is 'nasty, brutish, and short'. His theory of the state presupposes that individuals voluntarily submit to the power of a sovereign in order to escape the dangers associated with the anarchic state of nature. Hobbes stopped short of suggesting, however, that this logic should encourage states to submit to a world government; he acknowl-

edged that although every state needs to be constantly ready to fight for its survival, inside the state individuals experience a degree of security that is sufficient to allow them to concentrate on their own welfare without being constantly preoccupied with threats to their survival. Hobbes, therefore, disputes the 'domestic analogy' (drawn by liberals such as Dickinson, 1937) that equates the state of nature with the anarchic international system.

Contemporary neo-realists and neo-liberals (liberal institutionalists) go further and dispute that the absence of government necessarily generates disorder. But, while neo-realists are mainly concerned with how the balance of power creates order within competitive anarchic systems, neo-liberals wish to show that anarchy does not inhibit the emergence of cooperation. Neo-liberals are drawn to literature, by theorists such as Nozick (1974) and Taylor (1976), that disputes the Hobbesian assumption that the state is necessary to bring about order. More recently, however, it has been suggested by constructivists (such as Wendt, 1992) that neo-realists and neo-liberals have failed to note how units with different sets of interests and identities necessarily constitute divergent conceptions of anarchy. More fundamental criticisms levelled against neo-realists and neo-liberals are that their debate has helped to reify the distinction between domestic and international politics (Milner, 1991), and that it has diverted attention from the persistent significance of hierarchy in the international system (Watson, 1997).

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Andean Common Market

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RICHARD LITTLE

Andean Common Market

At the time of its formation in 1969, the Andean Common Market (or Andean Pact) was considered one of the most innovative INTEGRATION movements in Latin America. It called for creation of a full common market, with controls on foreign capital, harmonization of industrial policies and production, preferential treatment for least-developed members, and strong institutions and implementation mechanisms. The pact was organized as a subregional group within the Latin American Free Trade Association (now the Latin American Integration Association). Its original membership included Bolivia, Chile, Colom-

bia, Ecuador and Peru. Venezuela joined a couple of years later, but Chile withdrew after a military coup brought to power a government with strong neo-liberal economic views (see NEO-LIBERALISM). Peru also decided to suspend its active membership of the pact in 1992, promising to resume participation at a later date. Despite these setbacks, intra-regional trade has shown impressive gains and common external tariffs (CETs) have been established.

WILLIAM P. AVERY

ANDEAN PACT see Andean Common Market

Anderson, Perry (1938–)

In his positions as editor and then as editorial board member of the *New Left Review*, Anderson has been perhaps the most influential figure of the second generation of Britain's New Left. In his seminal essay of 1964 – 'Origins of the present crisis' (1992a) – he argued that England had experienced an immature and impure bourgeois revolution. This ensured a continued aristocratic HEGEMONY within the British state. The consequences of this were two-fold. First, Britain's economic decline was explained. Second, without a hegemonic bourgeois ideology upon which to base its own ideological development, Britain's proletariat proved incapable of developing an indigenous Marxism. To remedy this situation, Anderson introduced (through the pages of *New Left Review*) a number of continental Marxist philosophers to the English speaking world, as a means of grafting Marxism onto Britain's Left. In two majestic books, he attempted to trace the genealogy of the European state system as an (unsuccessful) attempt to finally settle the strategic problem of the viability of the Russian Revolution of 1917 as a guide to socialist strategy in the West (1974a; 1974b). In a shift towards TROTSKYISM in the 1970s, he became more critical of Western Marxism. He argued that it was a

philosophical deviation from Marxism, born of proletarian defeats (1976). During the late 1980s, he became more pessimistic as to the viability of the socialist project, to the extent that he unenthusiastically and critically accepted the 'end of history' thesis of FRANCIS FUKUYAMA (1992b).

See also:

Marxism–Leninism; Marxian economics

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PAUL BLACKLEDGE

Angell, Norman (1872–1967)

Although Norman Angell was born in Holbeach, Lincolnshire, and died in Croydon, Surrey, he spent much of his early life in the United States, where he worked as a cowboy, a homesteader and finally as a journalist. Returning to Europe, he became editor of the European edition of *The Daily Mail* in Paris. After the success of his 1910 book, *The Great Illusion*, Angell left journalism and (except for a brief spell as a Labour MP between 1929–31) devoted his life to writing and lecturing on international affairs. He was knighted in 1931 and received the Nobel Peace Prize in 1933.

Angell's writing can be divided into two distinct periods. Before World War I, he exhibited a strong faith in human social progress and concentrated on developing a rigorous intellectual defence of Cobdenite international LIBERALISM (see COBDEN, RICHARD). After 1918, he lost faith in Cobdenite

liberalism and became an advocate of international organizations and collective security. Throughout both periods, however, he remained committed to developing an international system that would safeguard both peace and prosperity, and he remained deeply suspicious of the role of NATIONALISM.

In *The Great Illusion*, Angell anticipated the late twentieth-century ideas of GLOBALIZATION and INTERDEPENDENCE, arguing that the growth of trade and (especially) finance meant that the world now formed one vast integrated economy. As a result, war no longer made economic sense and a war between the great powers would threaten the very basis of Western prosperity and civilization. In later works, Angell argued that World War I had been caused by mass public delusions (what he termed the 'public mind') which had blinded people to the realities and fragility of international prosperity and interdependence. He became convinced that an international rule of law, guaranteed by the collective security system of the League of Nations, was necessary to safeguard world society. During the 1930s, he actively campaigned for collective action against fascism in Germany, Italy and Japan, and wrote stinging criticisms of appeasement.

Central to Angell's view of international affairs was the idea that, while our prosperity relied on the processes of global interdependence, interdependence itself was fragile and easily destroyed. Reasoned judgement would lead us to realize this fact, but the unthinking passions inherent in the 'public mind' led whole peoples to follow foreign policies that endangered global prosperity. The only answer was some form of global authority, bolstered by an intellectual freedom that would hopefully replace passion with reason. A strong believer in progress, Angell criticized both the balance of power and the doctrine of LAISSEZ-FAIRE as being solutions fit for an earlier stage of human evolution, but totally unsuited to twentieth-century conditions.

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appropriate technology

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LUCIAN M. ASHWORTH

appropriate technology

Debates about the 'appropriateness' of TECHNOLOGY date back to at least the 1950s, when the question was asked as to whether the choice of technology would be suitable for poor countries. Some economists questioned whether the production technique which was most profitable to a company was necessarily best for society. Market prices were alleged to give false signals because of 'imperfections' – due to trade unions and market monopolies – so the government should try (through taxes and subsidies) to promote the technology most appropriate for society. Neo-liberals countered by arguing that the best solution was to remove the market imperfections at source (see NEO-LIBERALISM).

In the 1970s, the debate switched to whether realistic choices of technique existed, given that most new techniques are devised in the advanced, high-wage countries. This generated two approaches. Some, like Francis Stewart (1977), argued that if there is only one realistic choice of technique for a particular product, then economic policy is best focused on changing the mix of products consumed, while others – inspired by E.F. SCHUMACHER (1993) and GANDHI – concentrated on trying to create new technologies more appropriate to particular social structures.

See also:

market failures

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CHRIS EDWARDS

Arab Fund for Economic and Social Development (AFESD)

The Arab Fund for Economic and Social Development (AFESD) is an Arab regional financial institution, established in Kuwait in 1968 to fund economic and social development projects in the twenty Arab states, as well as the Palestine Liberation Organization (PLO). AFESD commenced operations at the beginning of 1974.

In working with other Arab organizations (such as the ORGANIZATION OF ARAB PETROLEUM EXPORTING COUNTRIES (OAPEC) and the Arab Monetary Fund), AFESD (1) finances development projects, with preference given to overall Arab development and to joint Arab projects; (2) encourages the investment of private and public funds in Arab projects, and (3) provides technical assistance services for Arab economic and social development. More than half of the funds are used for energy-related projects.

ROBERT LOONEY

arbitrage

'Arbitrage' is the process of shifting funds from one INVESTMENT to another in order to secure the highest return. There are two main forms of arbitrage: interest arbitrage and commodity arbitrage. The aim of interest arbitrage is to distribute funds between financial centres in order to achieve the highest possible rate of return, subject to the least possible risk. Interest arbitrage will take place if the differ-

ence in the rates of interest offered between, say, two financial centres is larger than the cost of covering against the risk of expected changes in exchange rates (reflected in the difference between the spot exchange rate and the forward exchange rate – see **EXCHANGE RATE**) between those two centres. Such a disparity cannot persist: the process of arbitrage will eventually drive the two interest rates together. Similarly, commodity arbitrage takes place when price differences exist within a given market – for example, the market for cars. If the price of a car in Germany is lower than the price of an identical car in France, in general (taking into account transport costs and so on) it will be cheaper to import German cars into France and sell them there at the higher price. In these circumstances, the act of buying at the lower price and reselling at the higher price is known as arbitrage. The effect of this is to eventually eliminate the price difference between the two countries, hence arbitrage forms part of the process by which equilibrium will be reached in the car market.

Contemporary analyses of arbitrage are particularly concerned with the assumption that no arbitrage opportunities are available in a world of rapid and extensive information flows – an idea upon which many economic arguments are implicitly based – which reiterates the notion that arbitrage is inconsistent with a position of equilibrium (when preferences increase with quantity).

See also:

bonds; forward market; spot market

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ALISON M.S. WATSON

armed forces

'Armed forces' are military personnel, material and infrastructure at the disposal of governments, nominally for the purposes of national defence but often used for the projection of force beyond national borders and, especially in authoritarian states, sometimes directed at domestic groups opposing governmental authority. Armed forces variously consist of the combined strengths of ground, naval and/or air forces. The term can also refer to the military capabilities of non-governmental actors, such as guerrillas, armed nationalist groups, terrorists and even criminal organizations.

Modern armed forces are rarely called on to actively fulfil their main goal – the defence of national borders and territory. Rather, by demonstrating their capabilities they more often act as a deterrent to actors who would threaten national interests and goals. Many developed states therefore more often use armed forces to project their influence beyond national borders. This is especially true of France, the United Kingdom and the United States. Others that have had a firmly defensive posture in the post-World War II period are showing signs of moving to a more offensive posture (for example, Japan). Increasingly powerful developing states are also increasing their capabilities to do this (as in the cases of China and India).

Armed forces are also used to control domestic forces seeking to change or influence governments. Thus military forces are called on to perform police functions when the police are deemed incapable of maintaining the government's desired degree of order, sometimes with devastating consequences – as in the 1989 Tiananmen Square crackdown in China and the use of armed forces to quell unrest throughout Indonesia in 1998–9. Similarly, armed forces are used against armed opposition forces and nationalist groups – as in the cases of Mexico's **ZAPATISTA REBELLION**, the Irish Republican Army and other armed

armed forces

groups in Northern Ireland, and the Kosovo Liberation Army in rump Yugoslavia.

Armed forces may act in concert, as the US-led, UNITED NATIONS (UN)-endorsed armed forces did in the GULF WAR in the early 1990s (and are still doing through the ongoing enforcement of sanctions on Iraq) and the NORTH ATLANTIC TREATY ORGANIZATION (NATO) armed forces did in the 1999 war with Yugoslavia to reverse Serbian aggression and human rights abuses in Kosovo. Countries have for decades also placed small contingents of their armed forces at the disposal of the UN, which has deployed them throughout the world for the purposes of peacekeeping.

The Kosovo intervention by NATO points to one way that armed forces are being used in the post-COLD WAR period: humanitarian intervention. Increasingly, governments with surplus armed forces are using them in concert to protect human rights and bring humanitarian aid to suffering peoples. The clearest examples of this were the use of armed forces to protect Kurds in northern Iraq after the Gulf War, the UN (and particularly US-UN) intervention in Somalia in 1992 to bring food to people suffering from severe famine, and the NATO intervention in Kosovo, which was primarily justified by the severe suffering brought to that region by the Yugoslav leader, Slobodan Milosevic.

Since the end of the Cold War, many governments have cut expenditure on their armed forces. However, substantial sums are still directed towards national militaries. Globally, governments spend almost three per cent of their GROSS NATIONAL PRODUCT (GNP) on armed forces and related expenditure. The United States is by far the largest spender. Its defence budget is larger than the combined budgets of the states with the next thirteen largest militaries. This expenditure, of course, has consequences in that it diverts resources away from social spending, private RESEARCH AND DEVELOPMENT (R&D), and civilian investment. This is particularly devastating in many DEVELOPING COUNTRIES, where limited national resources are directed to the armed forces and not to meeting basic human needs.

Dubious wars can divert resources from meeting essential requirements of society, as in the border war between Ethiopia and Eritrea at the close of the twentieth century, where money was spent on arms and fighting the war while famine threatened.

Military establishments can be important domestic economic actors. For example, in China the military directly employs large numbers of people while also employing vast numbers in its multifarious business empire. Militaries can also play an indirect social welfare function, even in industrialized countries. In Germany, for example, large numbers of low-wage hospital workers are young people who chose the work as a legal alternative to mandatory military service.

Armed forces are frequently ineffective in achieving national objectives. States with nominally inferior capabilities have been able to defeat those with robust armed forces, as in the Vietnamese victory over the United States in the Vietnam War. Additionally, since 1945, nuclear weapons have sometimes made otherwise powerful states wary of using armed forces. Fearing that armed conflict could escalate to a nuclear confrontation, nuclear-capable states have sought to resolve their differences short of direct armed conflict. Furthermore, modern democratic states do not resort to the use of armed forces against one another, even when they are involved in trade 'wars'.

See also:

military industrial complex (MIC); power; war

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PAUL G. HARRIS

arms industry

The arms industry has a unique place in the political economy: because weapons technology is subject to ECONOMIES OF SCALE and because innovation plays a major role in firms' strategies, MARKET FAILURES abound in the arms industry; because of the industry's direct ties to national security, politicians and bureaucrats carefully scrutinize arms production; because governments are the only customers, lobbying strength joins price and quality as a key variable in business strategy.

The ratio of development cost to production cost of weapons is high, which yields static scale economies. The production process also benefits from learning effects (dynamic scale economies). Both drive the arms industry towards MONOPOLY. However, a firm's ability to extract rents is limited by quality competition between militaries. Because of the battlefield advantages of innovative weapons, militaries are rarely willing to purchase weapons lagging behind the state of the art. Although greater numbers of less-sophisticated weapons may yield more combat power than smaller numbers of expensive, cutting-edge systems, militaries often prefer high-technology. To keep up with this demand pull, arms manufacturers sometimes sacrifice the expected profits of long production runs in favour of high-risk product development. When militaries are not influential in defence policy-making (for example, when strategic threats are low), pork barrel politics may impinge on procurement decisions, inflating firms' profits or reducing pro-innovation incentives.

The arms industry is heavily regulated because of the industry's monopolistic tendencies and governments' interest in national security. Governments often seek direct control through NATIONALIZATION, but arsenals rarely are efficient technological leaders. Fixed-price

contracts with private firms often fail because of political and technological uncertainty, but ill-monitored cost-plus contracts that mitigate those risks are subject to RENT SEEKING. Some minimum level of public expertise is vital for monitoring contractor performance and for designing incentive regulation.

Great powers produce the largest volume of the most advanced weapons. Other countries make some weapons, particularly low-tech types, and they often produce parts for high-tech weapons to promote technology diffusion. Certain rogue states, to whom the developed countries avoid selling weapons, have invested in relatively sophisticated arms industries.

The smaller arms industries (including those of the rogue states) face pressure to export, which would spread development costs over additional sales. Some smaller producers have cooperated with restrictions on sales of advanced technology (for example, the Missile Technology Control Regime) but rogue states are less willing to cooperate.

Even among leading arms manufacturing nations like the United States and France, export controls have suffered from a PRISONERS' DILEMMA: Arms manufacturers and governments fear that if they do not sell weapons, their competitors probably will. Among the great powers, China has resisted limits on the arms trade as it seeks to build its technological capabilities. Financial pressure on Russia has also raised fears that firms will export advanced weapons to potentially unstable regions.

Many commercial products (for example, in the chemical and communications industries) may also be used to make advanced weapons. A narrow definition of the arms industry is becoming more difficult to enforce as DUAL-USE TECHNOLOGIES spread, hampering arms control efforts. Technological similarities between commercial and military products also may produce spin-off economic benefits, which might boost economic growth. Conscious efforts to diffuse innovations in process technology from arsenals (for example, at Springfield in Massachusetts) contributed to the INDUSTRIAL REVOLUTION. But today, because product-specific systems integration makes the

arms trade

biggest contribution to value added in both defence and commercial high-tech, spin-off products may only earn the normal economic rate of return.

See also:

military-industrial complex (MIC)

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EUGENE GHOLZ

arms trade

Although the arms trade is a persistent feature of international relations (IR), it has often been

ignored in analytic and policy circles. After World War II, analysts, academics and public officials interested in INTERNATIONAL SECURITY focused considerable attention on issues related to nuclear weapons. Chemical and biological weapons were given less attention, but were still the focus of major international campaigns and treaties. Major conventional weapons garnered far less attention at national and international levels, and light weapons even less. Nonetheless, major and light conventional weapons have been responsible for millions of deaths since World War II. Understanding the widespread effects of the arms trade is an important factor in comprehending the causes and consequences of conflict.

The international arms trade includes a variety of different types of transactions involving military goods and services. The goods and services involved may be weapons, support services or even military construction; they may be sold, bartered or given away; they may be new or deemed obsolete by the supplier. Some transactions take place in the open, others are conducted through covert means. Suppliers and recipients may include countries, companies, military establishments or insurgent groups.

Trends in the international arms trade

While analysts and advocates alike have devoted more attention to the international arms trade in recent years, it is not a new phenomenon. In the 1930s, the Nye Committee in the United States studied the 'merchants of death' who sold weapons for profit; in the 1940s, the LEND-LEASE PROGRAMME provided weapons and war material for the Allied war effort. The 'modern' arms trade dates largely from the 1960s: a key factor was President Kennedy's decision to move from transferring surplus World War II vintage weaponry for free to selling newer weapons. The increased emphasis on weapons sales was reinforced in the 1970s by Britain's decision to withdraw from east of Suez and by the implementation of the Nixon Doctrine, which supported the militarization of Israel and Iran as regional

'policemen' within the Middle East. Both of these decisions were cited by countries in the affected regions as reasons to seek additional weaponry. New weapons were much easier to obtain after the 1973 Middle East war (see YOM KIPPUR WAR), when increases in the price of oil in a very short period of time dramatically increased the access to cash of the ORGANIZATION OF PETROLEUM EXPORTING COUNTRIES (OPEC). With cash resources, countries demanded modern weapons, which were seen as both a means of bolstering their defences and symbols of modern militaries and societies.

The COLD WAR provided a structure for the arms trade. States were generally the suppliers and the recipients: recipients tended to choose sides and remain with either the NORTH ATLANTIC TREATY ORGANIZATION (NATO) or Warsaw Pact countries as their dominant suppliers. While countries sometimes chose to switch sides (as Egypt did in the 1970s, changing from the Soviet Union to the United States), this was not common. Suppliers sometimes provided weapons to insurgent groups, but most transactions were on a state-to-state basis.

As has been the case for many years, the trade in major conventional weapons is dominated by the 'big six' – the five permanent members of the United Nations Security Council (UNSC) (China, France, Russia, the United Kingdom and the United States) and Germany. According to the Stockholm International Peace Research Institute (SIPRI), these countries generally account for between 80 and 90 per cent of the US dollar value of the world's trade in major conventional weapons each year.

In recent years, however, the international market for major conventional weapons has varied. According to SIPRI, the volume of exports of major conventional weapons decreased by roughly 50 per cent between 1987 and 1995. This trend moderated in the mid-1990s, but the market did not return to mid-1980s levels.

The dissolution of the Soviet Union produced three major changes in the international

weapons trade. The most significant change was with respect to major suppliers. According to SIPRI, the Soviet Union/Russia accounted for 43 per cent of the world trade in major conventional weapons in 1986, falling to 40 per cent in 1987 and accounting for less than 20 per cent in each year from 1991–9. At the same time, the United States' share increased from less than 30 per cent in 1986, to nearly 50 per cent in 1991 and more than 50 per cent in 1992 ⁴. Its share dropped to between 40 and 50 per cent in 1995 ⁷, recovering to more than 50 per cent in 1998–9. Germany, the United Kingdom, China and France generally filled out the top ranks of suppliers.

During the Cold War, Soviet weapons sales had frequently featured concessionary payment terms; after the Cold War, the need for hard currency in Russia meant that such terms were no longer readily available. As a result, many traditional clients were unable to afford continued purchases. Clients with access to hard currency increasingly demanded cooperative arrangements, with some of the weapons' development or production taking place in the recipient country. Such arrangements have increased access to production technology in countries such as China and India.

Other suppliers have also experienced domestic pressure to increase their foreign markets. With falling defence budgets, many suppliers have turned to exports as a means of subsidizing domestic purchases and trying to keep supply lines open. Their clients have also been successful in obtaining access to production technology as a condition of sales. Offset arrangements, in which the supplier country agrees to offset the cost of the recipient's purchases by buying other products from the recipient, have also been increasingly common.

Light weapons

In recent years, analysts, advocates, journalists and public officials have paid increasing attention to the issue of light weapons. These weapons had been largely overlooked in analyses of the international weapons trade,

even though they have probably been responsible for most of the killing in conflicts since World War II.

While there is no agreed definition, most analysts consider light weapons to include small arms (such as revolvers and pistols), as well as rifles, machine guns, portable anti-tank and anti-aircraft missile systems, anti-personnel landmines and some mortars. (In work on light weapons at the United Nations in 1997, mortars under 100 mm calibre were counted as light weapons; mortars that exceeded this size were not.)

For many countries and in many conflicts, light and major conventional weapons are aspects of the same phenomenon. There is no dividing line on the battlefield between light and major conventional weapons: they are used in many of the same conflicts. Important aspects of the light-weapons trade – such as covert transfers to governments or insurgents, illicit transfers, transfers to non-state actors, transfers in return for goods, direct government-to-government transfers and legal sales by companies – are also key factors in the trade in major conventional weapons.

Black market sales, theft and transfers from one insurgent group to another are often much more significant factors with respect to light weapons than with major conventional weapons. By definition, light weapons are smaller and more portable, hence more easily smuggled. In addition, their low dollar value makes them more accessible to groups with limited financial resources. The dominance of different types of transfers will vary depending on the region, and the type and stage of conflict. Nonetheless, there are important similarities in the transfer of light and major conventional weapons, and both types of weapons are regularly being used in most recent and current conflicts.

Much of the current information about the light-weapons trade is anecdotal. These weapons are not covered in key sources, such as the United Nations Register of Conventional Arms. In addition, public information is difficult to obtain, since many light-weapons deals are illegal. Since many of the participants

are not state actors, customary routes for information gathering and dissemination are often irrelevant.

The debate

Advocates of weapons transfers argue that weapons transfers help both suppliers and recipients. They contend that such transfers help suppliers by lowering the per-unit cost of weapons for their own forces, aid allies in providing for their defence without requiring politically and economically costly ground forces from the supplier country, and also ensure that forces have common systems and can fight together when necessary. Weapons transfers also help recipients (the argument goes) by creating stronger military forces that deter aggression from neighbouring countries, and by enabling them to create more powerful militaries than they could by using their often limited indigenous industrial capacities. Advocates of weapons transfers also contend that transfers can be part of a 'web of influence' binding the recipient to the supplier and increasing stability as a result.

Advocates of the restraint of arms transfers argue that such transfers divert money from needed social and economic programmes, create or exacerbate regional arms races, increase the risk of conflict and increase the costs should conflict occur. They say that suppliers often offer economic incentives for sales and loans at their taxpayers' expense, diminishing any economic benefit from sales. They also argue that transferring highly capable weapons increases the pressure for continued modernization of supplier ARMED FORCES, resulting in inflated defence budgets. According to advocates of restraint, instead of promoting supplier influence with recipients, weapons transfers are often used by recipients to exert control over suppliers. By threatening to turn to other suppliers, recipients are often able to get access to production technology and/or more sophisticated weaponry than they would otherwise receive.

Efforts at control

There have been many recent efforts to control the international weapons trade. However, they do not appear to have prompted restraint on the part of either suppliers or recipients.

After the GULF WAR, amid public concern over the leading suppliers' contributions to the Iraqi arms build-up, the five permanent members of the United Nations Security Council met to discuss the prospects for limiting weapons transfers. One of the few tangible results of these meetings was the United Nations Register of Conventional Arms. Established in 1991, the UN register is a voluntary effort by governments to report their imports and exports of seven categories of major conventional weapons: battle tanks, armoured combat vehicles, large-calibre artillery systems, combat aircraft, attack helicopters, warships and missiles/missile launchers. In addition, countries are invited to submit supplemental information on their stockpiles of these types of weapons and on their procurement of these weapons through national production. While more than 130 countries have participated in at least one year of the register, only about 90 countries usually participate in any given year. According to the resolution establishing the register, it is intended to 'prevent the excessive and destabilizing accumulation of arms'. However, it does not include measures to prevent such a build-up, to determine when it has taken place or to reverse it.

Another possible avenue for restraint is the Wassenaar Arrangement on Export Controls for Conventional Arms and Dual-Use Goods and Technologies. The Wassenaar Arrangement, agreed in December 1995, is named after the town in the Netherlands where agreement on the organization was reached. It is a multilateral arrangement with more than thirty countries as members, and was constructed as a follow-on to the Coordinating Committee for Multilateral Export Controls (COCOM). The Wassenaar Arrangement covers the export of both weapons and DUAL-USE TECHNOLOGIES. To date, at the insistence of the United States, it

has focused largely on major conventional weapons exports to a few 'rogue states' – Iran, Iraq, Libya and North Korea. Other suppliers contend that the United States is only interested in restraining weapons transfers to countries that are not its clients. This suggests one of the most significant barriers to limiting weapons transfers: one country's rogue is another country's key client.

A third possible route towards restraint consists of efforts to set international standards for weapons transfers. These efforts, often embodied in 'codes of conduct', bar transfers to countries that systematically abuse the human rights of their citizens, fail to carry out free and fair elections or are engaged in acts of armed aggression. Such codes have been agreed or are under discussion in the EUROPEAN UNION (EU), the Organization for Security and Cooperation in Europe (OSCE), the UNITED NATIONS (UN) and the US Congress.

See also:

aid, multilateral; arms industry; developing countries; international security; war

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The advent of the World Wide Web has significantly increased access to timely information about weapons trade issues. Organizations that maintain active websites include the Bonn International Centre for Conversion, the British American Security Information Council, the Center for Defense Information, the Federation of American Scientists, the Monterey Institute for International Affairs and the United Nations.

NATALIE J. GOLDRING

Arrow, Kenneth Joseph (1921–)

Kenneth Arrow received both his MA and Ph.D. from Columbia University, before becoming a research associate at the Cowles Commission for Research in Economics between 1947 and 1949. Although the latter was originally set up for the purpose of research into the determination of stock-market prices, the Cowles Commission soon became famous for its work in the field of mathematical

economics, an area to which Kenneth Arrow has made a significant contribution. Indeed, Arrow received the Nobel Prize for Economics in 1972. On leaving the Cowles Commission, Arrow took up a post at Stanford University, where he remained until becoming Professor at Harvard in 1968. He subsequently returned to Stanford and is currently Emeritus Professor there, a post that he has held since 1991.

Arrow has researched in a number of significant areas, some of which have direct relevance for the political scientist in general and the international political economy (IPE) analyst in particular. Much of his work has been concerned with the way in which the economic system operates in order to achieve optimal EFFICIENCY, stressing the importance of decentralization in this. It is his work in the area of social choice however, beginning with his volume on *Social Choice and Individual Values* (1951; see Arrow, 1983), which is of perhaps most relevance to the field of IPE. Here Arrow stresses – in his so-called ‘impossibility theorem’ – that it is impossible to have a set of rules for a group (that is, a constitution) that (while retaining, at the very least, certain desirable attributes) can transform the preferences of the individual members of the group into a harmonious set of preferences for the group as a whole (a social welfare function). This so-called ‘paradox of voting’ (also known as Condorcet’s paradox) means that majority voting over pairs of alternatives may, in fact, lead to inconsistencies in the ranking of the choices with which the voter is faced. Kenneth Arrow’s major achievement was to demonstrate that this paradox could arise in any number of voting schemes in any number of social groups, from local government elections right up to voting in international organizations. For a political scientist, then, the relevance of Arrow’s work is in his analysis of the properties inherent in a given political process that will bring about the existing set of group preferences.

In addition to such work, Arrow has also examined the field of uncertainty in economics, particularly the issue of decision-making under uncertain conditions. More recently, Arrow has

become involved in the examination of the economic and social dimensions of climate change. Such work once again demonstrates Arrow's contribution to the analysis of economic issues that have a direct impact on the conduct of social-science research.

See also:

public choice (PC) theory; rational choice; risks

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ALISON M.S. WATSON

ASEAN Free Trade Area (AFTA)

At the fourth ASSOCIATION OF SOUTH-EAST ASIAN NATIONS (ASEAN) summit in Singapore in January 1992, the ASEAN members (Brunei, Indonesia, Laos, Malaysia, Myanmar, the Philippines, Singapore and Thailand) signed the Singapore Declaration, by which they committed themselves to intensify their economic cooperation within the entire region and to strengthen the economies of ASEAN's member-countries. They agreed to establish an ASEAN Free Trade Area (AFTA) within fifteen years. The AFTA officially started in January 1993. It can be considered the biggest step towards regional economic INTEGRATION since the establishment of ASEAN in 1967. Despite scepticism about the effectiveness of regional organizations, ASEAN has proved to be quite successful. Its member-states all have fairly dynamic economies. They are sometimes referred to as the 'Little Dragons'. A free trade area in ASEAN means that obstacles to a freer trade between member-states should be removed, including the abolition of high TARIFFS

or taxes on traded goods. Furthermore, quantitative restrictions (QRs) and other NON-TARIFF BARRIERS (NTBs) are to be discarded. Each member remains free to set its own level of tariffs on imports from non-members. ASEAN members hope that the implementation of AFTA will lead to a competitive advantage for the ASEAN region. An increase in FOREIGN DIRECT INVESTMENT (FDI) and the development of home companies into outward-looking enterprises that are able to compete in world-markets are also hoped for.

See also:

regionalism

MEHDI PARVIZI AMINEH

Asian corporatism (AC)

Confucianized corporatism

Asian corporatism (AC) – popularly known as 'Confucian political economy' – reworks European corporatism along Confucian lines. Instead of state, labour and capital 'consociationalism' (as found in certain western European states, like the Netherlands), AC economies substitute labour with 'monopolies of representation' to share national decision-making with state and capital. (Indeed, AC economies generally prohibit union activity through legal sanctions, enterprise-level controls and/or high transactions costs.) These 'monopolies of representation' or trade associations consist of quasi-governmental organizations that share a high degree of functional and institutional INTEGRATION. They facilitate relations between the state and firms, usually with government agencies leading interest-group planning. Such authority tends to insulate national bureaucrats from 'private interests', accounting for their 'relative autonomy'. The middle class in AC economies may be highly competitive and economically minded, but it remains docile politically. It depends on the state for lucrative contracts,

Asian corporatism (AC)

licences, patents, tax exemptions and/or long-term loans, especially for overseas investments. East Asia's recent economic crisis underscores this dependency all too vividly. Demands for social equity or other types of protest thus fall primarily to a culturally accepted vanguard: students. Confucian tradition grants them the privilege of dissent, much as indulgent parents may to unhappy children.

Converging conflicting norms and practices

AC states command greater political authority in economic development due to Confucian tradition. Confucianism typically conveys leadership in the form of parental benevolence to innocent and child-like subjects. Historically, representatives of the state enjoy the status of 'father-mother officials' (*fumu guan*) who command the filial piety of their subjects. This relationship may be loving, but it is also decidedly top-down, instructional and, if necessary, punitive. Confucian canons routinely compare rulers and subjects to 'drivers' and their 'mules'; 'vases' and 'water'; 'shelter' to hapless, cowering 'victims' seeking refuge from raging storms. Implicit within this is a moral obligation for rulers to protect their subjects, just as it is the public duty of subjects to serve their rulers. (Rulers lose their 'mandate of heaven' when they fail to uphold their end of the bargain.) Confucian governance sanctifies filial piety both to parents and to state, given that one reflects and sustains the other.

Westphalian capitalism, in contrast, celebrates the individual as opposed to the family-state indeed, the Treaty of Westphalia (1648) formalized the inter-state system that we know as international relations (IR) today. Grounded in liberal theory and neo-classical economics, it promotes individual entrepreneurship to enrich the self before others. Indeed, the ADAM SMITH slogan still resounds: 'private vice, public virtue'. Recent examples surface in 'trickle-down' pronouncements by supply-side economists for industrialized economies (see SUPPLY-SIDE ECONOMICS) and 'shock therapy' for post-socialist ones. West-

phalian capitalism also emphasizes limited government, particularly for the market which should be left to ride out its periodic 'laws' of boom and bust, profit and loss, expansion and reduction. With these contending worldviews as backdrop, how did AC development emerge?

Hybridity in action

AC development effectively hybridizes Confucian norms with capitalist practices to produce a market-oriented, state-led regime. It exhibits four key compromises:

- 1 *Collective individualism*. AC development collectivizes the neo-classical, liberal individual into the corporation or a comparable family-like work unit. Typical examples include the *keiretsu* in Japan, *CHAEBOL* in Korea, business federations in Taiwan and Singapore, family firms in Hong Kong.
- 2 *Utilitarian personalism*. AC transactions apply traditional principles of personalism (*guanxi*) to the family-institution's business. Japan's informal subcontracting system (*shitaue*), for example, utilizes age-old principles of village organization (*mura*) to balance between integration and independence for subcontractor and 'parent' firm.
- 3 *Patria economicus*. As the grandest family-institution, the AC state is *morally obligated* to protect the welfare of the people, now measured in terms of GROSS NATIONAL PRODUCT (GNP) and per capita income, just as the people have a *public duty* to follow the AC state's policies.
- 4 *State-mobilized learning*. Accordingly, various nationalist goals can be translated into developmental terms: for example, to 'catch up' with the industrialized West (Japan), to 'gain independence' from former and future imperialists (China, Vietnam), to 'fight communism' (Hong Kong, Singapore, South Korea and Taiwan). AC governments and enterprises thus often collaborate to mobilize skills acquisition to facilitate economic development.

Hypermasculinity in common

Patriarchy facilitates this convergence between Confucianism and Westphalianism. For Westphalian capitalism, patriarchy takes on a racialized, sexualized form with the advent of COLONIALISM and IMPERIALISM. Note these renditions (all from Shohat, 1991) of conquest and empire:

[The New World is] a country that hath yet her mayden head, never sakt, turned, now wrought.

(Sir Walter Raleigh)

Here nature opens her broad lap to receive the perpetual accession of new comers, and to supply them with food.

(St John de Crevecoeur)

Never again may mortal men hope to recapture the amazement, the wonder, the delight of those October days in 1492 when the New World gracefully yielded her virginity to the conquering Castilians.

(Samuel Eliot Morison,
Admiral of the Ocean Sea, 1942)

Colonialism itself was seen as an extension of national manhood. Note too the underlying imagery of rape in this seventeenth-century rationalization of empire-building:

Colonization is the expansive force of a people; it is its power of reproduction; *it is its enlargement and its multiplication through space*; it is the subjection of the universe or a vast part of it to that people's language, customs, ideas, and laws.

(Quoted in Said, 1979: 219; emphases added)

Confucian patriarchy, in turn, centres on family relations more than sexuality. It casts women as daughters, sisters, wives and mothers. At each stage of her life, a woman must rely on and defer to a male authority figure: for example, father, brother, husband, son. The 'three bonds' (*san gang*) solidify patriarchy with power by stipulating three sets of superior-to-subordinate relations: ruler-to-

subject, father-to-son, husband-to-wife. Note, for example, a fifteenth-century text from Korea, the *Naehun* (Instructions for Women). Codified by Queen Han Sohyunwanghoo in 1475, the *Naehun* has gone through several modern editions. It is no longer widely read in Korean society today, nevertheless its strictures are well known and still cited by the public to guide the behaviour of young women. It builds on the basic Confucian principles to outline four main responsibilities for proper Confucian womanhood: womanly virtue (not outshining men), womanly speech (not arguing or debating with others, especially men), womanly appearance (modesty and pleasantness) and womanly work (diligence without brilliance). The *Naehun* states:

Maintaining differences between men and women ensures sincerity between husbands and wives. From this, fathers and sons will be close; kings and ministers will be proper. As the ancients said: 'the most fundamental of all rites is marriage'.

Civilization as we know it would collapse, the *Naehun* warns, without orderly management of the household. It would be comparable to having 'a hen crow'. To ensure against such chaos, the *Naehun* denotes three duties for the proper Confucian daughter-wife: serving her parents-in-law, obeying her husband and caring for her children.

The AC economy combines these traditional strictures on women with capitalism's desire for them as objects and labour. Whether cast as 'good wife, wise mother', 'nimble fingers' and 'docile nature', 'Singapore girl', 'sarong party girl' or just 'prostitute', AC economies turn women into servants for the household, the market, the state and the world economy. Government policy, trade journals, textbooks, fiction, editorials, advertisements, commercials, movies, even news reports constantly hawk the Asian woman as economically productive but socially expendable *and* family-defined. This image-making seals local and global patriarchal interests into a common developmental hierarchy that is intrinsically racialized and sexualized.

Asian crisis

Note these two advertisements, the former from a 1994 Asian edition of *Newsweek* and the latter from a 1997 issue of a women's magazine from Singapore:

Come to the Banyan Tree with your wife and leave with a different woman.

[The advertisement features an Asian woman with her naked back to the viewer, long black hair swept to one side.]

My father really wanted a boy, so in school I had fights with boys and climbed trees and then much later I should have become a piano teacher, instead of studying law and then travelling around Europe. But the strange thing is, now I am a woman, men see me in a different light. And then one day I came home and Dad looked at me and said, 'that necklace is just beautiful on you'

Both images present the Asian woman as object or purveyor of consumption. Her labour and intrinsic worth disappear in the neon glare of Confucian father-knows-best capitalism.

Conclusion

Asian corporatism is neither traditional nor modern, liberal nor hegemonic, East nor West, but is instead both and more. The West needs to recognize its complicity in creating Asian corporatism, not just lambast it as 'unfair' or, more recently, full of 'cronies'. Similarly, AC economies must assume *true* Confucian responsibility – which means protecting their daughters, sisters, wives and mothers, not just the capitalist bottom-line.

See also:

Asian crisis; East Asian model; Four Tigers (Asian)

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L.H.M. LING

Asian crisis

The 'Asian crisis' is generally considered to have followed the decision by the Bank of Thailand to devalue (see DEVALUATION, CURRENCY) the baht on 2 July 1997, consequent to loss of reserves after pressure on the Thai currency. In the following CONTAGION, the currencies of other East Asian countries (in particular Malaysia, Korea, the Philippines and Indonesia) came under attack. The economic recession within the region was both severe and of long duration, being still in evidence at the beginning of 1999, and has had a significant impact across the world – most strongly in Russia, where domestic weaknesses were again exposed, and in Brazil.

Following the decision of the bank to float the baht, it depreciated by as much as 15 per cent in the first week, with other regional currencies following in its wake. Changes in the most affected countries were not uniform, however: by the end of January 1998, the Philippine peso had fallen in value by about 36 per cent, the Korean won and Malaysian ringgit both fell by 42 per cent, the baht by 53 per cent and the Indonesian rupiah by 80 per cent. Stock markets in Korea and Thailand, in particular, had been subject to pressure

throughout 1996, in advance of the currency crisis. Thus, between the end of June 1997 and the end of January 1998, stock-market price falls in excess of 50 per cent occurred in the first four countries above and of about 80 per cent in Indonesia.

A particular feature of the Asian crisis was that, unlike similar events previously in Latin America, where governments had engaged in profligate spending leading to BUDGET DEFICITS, here savings-investment imbalances occurred in the private sector, despite very high levels of domestic saving, and were not related to excessive public spending. In the affected economies, gross domestic saving was about 33 per cent of GROSS DOMESTIC PRODUCT (GDP) throughout the 1990s and the fiscal balance, after being positive throughout, was only minus 0.2 per cent in 1997. The overall INFLATION rate during 1997, as calculated by the ASIAN DEVELOPMENT BANK (ADB), was just 5.1 per cent.

Different views have been expressed regarding the essential causes of the crisis, in particular whether it stemmed from domestic economy and policy weaknesses ('fundamentals') or was associated with global instability in international financial markets and capital flows.

The former view accepts that, by and large, the countries immediately concerned had pursued relatively prudent MACRO-ECONOMIC POLICIES, without significant budget deficits, with low rates of inflation and high rates of saving. It is argued, however, that a number of weaknesses combined to create uncertainty for international investors, in particular. Once international capital identified these weaknesses, rapid outflow produced cumulative downward effects on investment and credit availability, and, with these, corporate liquidity problems and insolvencies.

Of the domestic factors, the most emphasized has been the state of the financial sector, where the banks had not been subject to effective REGULATION in terms of quantity and quality of LENDING or of matching maturity conditions for their assets and liabilities, relying to an excessive extent on often

short-term external funds. Non-banking financial companies, subject to little or no regulation, were also involved in the process, particularly in feeding booms (such as within Thailand's property market). Related to the above was a lack of transparency in both financial and corporate sectors, and failure to adhere to best practice in financial reporting and disclosure of accounts.

There were, in addition, a number of specific factors operating in different countries leading to inefficient allocation of financial capital: political influence in Thailand; 'crony capitalism' in Indonesia; and over-extension of the large family-run conglomerates (*CHAEBOL*) in Korea, in the last case not always ensuring good use of funds by subsidiaries and making excessive use of debt finance rather than equity capital.

In part because of lax financial regulation, FINANCIAL INSTITUTIONS and business corporations were able to rely on large ratios of short-term funds rather than direct investments, becoming highly leveraged and susceptible to outflow of capital and reduction in credit access. As a result of habituation to pegged currencies and a perceived lack of exchange risk, foreign borrowing was largely unhedged against CURRENCY DEPRECIATION relative to the dollar once contagion took hold, leading to a downward spiral of debt, insolvency and further loss of confidence in currencies and economies.

The banking sector itself was vulnerable as a result of the commercial banks (1) expanding their foreign liabilities over several years at a much faster rate than their foreign assets; (2) accepting as collateral for loans both real estate and equities of which the prices contained a significant speculative element; and (3) developing a mismatch in maturity dates between their assets and liabilities.

Other factors contributing to the crisis were external. While the wisdom of adhering to pegged exchange rates as policy has been questioned, the appreciation of the US dollar from mid-1995 resulted in appreciation of local currencies and thus loss of competitiveness within the region - a situation exacerbated by

the depreciation of the Japanese yen and the 1994 devaluation of the renminbi by China. Stagnation in Japan's economy also affected demand and slowed growth in the region. According to some observers, world over-production in certain products particularly important among Asian regional exports – electronics especially, but also garments, as well as steel – had a significant effect on the situation. The export slowdown in 1996, resulting from a combination of these factors, was reflected in widening current-account deficits, raising doubts among investors regarding the strength of the economies concerned. This affected the inflow of foreign capital and, through this, confidence in the maintenance of prevailing exchange rates, initially the baht.

A distinct external factor put forward as more fundamental, however, is an inherent instability in global capitalism. With lower rates of return and high bank liquidity in the West, funds flowed readily to what were regarded as 'Asian miracle' countries, without adequate attention by lenders to credit risks, so that, in addition to the irresponsible borrowing described above, there was what might be described as irresponsible lending. One widely quoted example was the hedge-fund 'giant', Long Term Capital Management, based in Connecticut, which borrowed heavily, made risky investments across many markets and would have failed in late 1998 but for a US\$3.6 billion injection of cash by brokerage firms and banks. From the late 1980s, there had been a massive surge of capital inflow into the five countries, amounting cumulatively over the period 1987–96 to US\$314 billion. A relatively small proportion of this was in the form of FOREIGN DIRECT INVESTMENT (FDI), a large part comprising PORTFOLIO INVESTMENT or coming via banks and finance houses.

The view that international capital market instability has been the basic problem is supported by the huge volume of short-term funds that moved into and out of the region prior to and during the course of the crisis, and by the fact that, notwithstanding the lack of transparency mentioned, many of the domestic

factors listed were well-enough known in broad terms prior to the crisis. Nevertheless, it can safely be concluded that the crisis was the outcome of a combination of both domestic and external factors.

The social impact of the crisis has been severe in the affected countries. As a result of the business failures and retrenchments, there has been a marked rise in unemployment and various kinds of underemployment, with firms cutting the wages and benefits of those remaining employed. The worst affected country has been Indonesia, which was also hit by civil disturbances following sharp rises in the level of prices. Unemployment there was estimated to be as high as 15 per cent by June 1998 (double the figure for a year earlier) and 20 per cent at the end of 1998. The demand for immigrant workers has also fallen throughout the region, affecting countries which rely in part on the export of surplus labour and on remittances from abroad. With government revenues diminished as a result of recession, and public expenditure diverted towards financial restructuring and servicing of debt, social-service provision has been seriously affected, reducing access by vulnerable groups, in particular, to healthcare and education.

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IAN LIVINGSTONE

Asian Development Bank (ADB)

Established in 1966 to foster economic development and regional economic cooperation, the Asian Development Bank (ADB) comprises regional and non-regional members and has its headquarters in Manila, the Philippines. Japan played a crucial role in the establishment of the ADB and made an initial contribution to the ADB equal to the United States' initial contribution. Many authors assert that the ADB is little more than a foreign-policy tool of Japan and that it is a key component of Japan's overall strategy to gain prestige in the international system. Others recognize the important position of the United States in the ADB. Indeed, Japan hesitated in supporting the original proposal for the ADB until the United States committed itself to the idea of an Asian RDB. More recently, Japan and the United States have come into outright conflict over policy issues in the ADB.

The ADB's Articles of Agreement mandates that Asian members comprise a minimum of 60 per cent of the voting weight, with 20 per cent of total votes distributed equally among members. Its governing structure is bifurcated into a Board of Governors and a Board of Directors. The Board of Governors delegates most decisions to the smaller Board of Directors. However, the governors retain decision-making authority over many internal governance issues, such as admitting new members. Yet the Board of Directors often negotiates governance issues that officially fall under the auspices of the governors. The major limitation placed on the Board of Governors is that it meets only once a year, while the directors meet in continuous session. The Board of Directors currently consists of twelve representatives split between regional and non-

regional members. Three countries have individual representation on the Board of Directors: China, Japan and the United States. The remaining fifty members of the ADB are divided into nine voting groups. Each voting group elects one representative to the Board of Directors.

JONATHAN R. STRAND

Asia-Pacific Economic Cooperation Forum (APEC)

Established at a meeting in Seattle in the United States during 17–21 November 1993, the Asia-Pacific Economic Cooperation Forum (APEC) is a forum for the exchange of views and information among the member-states of the 'Pacific-rim' and for the promotion of greater economic INTEGRATION within this putative region. APEC was initially composed of Australia, Canada, China, Hong Kong, Indonesia, Japan, Malaysia, New Zealand, the Philippines, Singapore, South Korea, Taiwan and the United States.

While APEC constitutes a group of some of the most dynamic economies in the world, with considerable prospects for future growth and mutually beneficial economic interaction, its purposes and prospects remain unclear. The earlier conclusion of the NORTH AMERICAN FREE TRADE AGREEMENT (NAFTA) threw doubts on the commitment of the United States and Canada to any alternative framework for 'regional' economic integration. There were also suspicions that a primary purpose of APEC was to create a counterweight to the ASSOCIATION OF SOUTH-EAST ASIAN NATIONS (ASEAN) and to the anti-Western slant that it had tended to adopt in the early 1990s under Malaysian influence.

R.J. BARRY JONES

Asiatic mode of production

Although not important either to the structure or to the development of twentieth-century European MARXISM, the concept of an Asiatic MODE OF PRODUCTION has both a significant and a rather curious place in the thought of KARL MARX and Frederick Engels. Articles reporting and analysing the so-called 'Asiatic mode' appeared as early as 1853. India and China were always the paradigm cases of such a mode, but Egypt, Mesopotamia, Persia, Arabia and Turkey were also designated 'Asiatic', also Java and the Dutch East Indies, as well as Spain under the Moors and Mexico under the Aztecs. It was thus possible to be 'Asiatic' without being in geographical Asia. Japan, by contrast, was resolutely feudal, while Russia itself was 'semi-Asiatic' – a characterization to which Marx and Engels always adhered. The main structural features of this so-called mode of production were, apparently, a lack of private ownership of land, a social structure dominated by self-sufficient village communes and, finally, a centralized state structure with commanding authority. The problem is not this definition, but why Marx considered the Asiatic mode to be a progressive mode (as he argued, for instance, in the famous preface of 1859, the so-called *Lietfarden* statement). He may have been simply considering the absence of private property in land: after all, he once described this to Engels as an 'oriental heaven'. But Marx and Engels were probably wrong about this. Where there was extensive peasant cultivation (as in both China and India), there was still private property in the sense of legal ownership, although there might be limitations on the right of sale, on partition and redistribution of land. The Asiatic mode was more of an invention than a historical reality.

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R.J. HALLIDAY

ASOCIACIÓN LATINOAMERICANA DE INTEGRACIÓN see Latin American Integration Association (ALADI)

asset specificity

Firms in some sectors of the economy devote considerable attention to litigation, the lobbying of government and other strictly non-economic activities. The term 'asset specificity' is used by economists when trying to account for variations in the level of this kind of activity according to sector, and directs attention to two distinct and variable features of assets: (1) the extent to which government policy typically affects the value of different classes of assets varies; (2) quasi-rents (defined as the difference between the value of an asset in its current use and its value in its next-best use) are also extremely variable. Owners of highly specific assets that are greatly affected by changes in government policy and command high quasi-rents have a very marked propensity to lobby; those whose assets are little affected by policy or can readily be deployed in alternative uses will be relatively disinclined to devote resources to lobbying. Typically, an industry characterized by high sunk costs and significant scale economies, for which the state is also an important purchaser, will devote more resources to government relations than a firm holding readily negotiable financial assets.

The student of international political economy (IPE) needs to relax the assumptions, implicit in much discussion of asset specificity, of the spatial immobility of assets and of a one-to-one correspondence of firms and assets. This is because, for many firms, the decision to devote resources to lobbying requires consideration of the relative returns in different

countries both to lobbying activity and to their assets. In addition, it must be borne in mind that most firms operate with a portfolio of assets, varying in the extent and precise character of their specificity. The way in which such concerns influence the marginal decision between market and non-market solutions may best be appreciated through examples. Within the manufacturing sector the steel industry has generally been characterized by higher asset specificity than the textile industry. Governments have been able to exert enormous influence (through commercial, regional, competitive and industrial policies) on the relative prices of the inputs and outputs of an integrated steel mill. Furthermore, such a mill (once built) is not easily transportable and has no alternative use that is anything like as remunerative as that for which it was designed. By contrast, textile industries have also been highly vulnerable to government policy (especially to changes in **TARIFF** and **NON-TARIFF BARRIERS** (NTBs)), but the relatively low cost of moving machinery from one customs area to another has been exploited since at least the 1930s to provide smaller downstream producers with an alternative to lobbying, an activity in which they could hardly hope to compete effectively with the largest, most vertically integrated and least movable firms. Looms are easier to move than steel mills.

Spatial mobility is, however, only one means by which functionally specific assets may be redeployed without appreciable sacrifice. To the extent that a firm's assets consist in management skills, reputation and strong brand names, they may be put to alternative uses within the same jurisdiction if this is less costly than lobbying to protect the viability of their original use. An example would be the diversification in the 1980s of the small British firm, Anglepoise Ltd, from lamp manufacture into the design and provision of lighting systems for entire office suites. Here, any attempt to regain control from a competitor of one intangible asset (in this case, the right to exploit the patent of the original Anglepoise lamp outside Britain) was thought likely to prove prohibitively expensive and the outcome doubtful. By

contrast, the firm's undoubted control over a second intangible asset (the trade mark 'Anglepoise') offered rents deriving from reputation that could be extended from manufacture of electric lamps to the much broader provision of lighting services. For a time, exploitation of the less specific of these two assets through the market was preferred to legal or political defence of the patent.

CHARLES JONES

Association for Payment Clearing Services (APACS)

The Association for Payment Clearing Services (APACS), set up in 1985, is a non-statutory association of major banks and building societies. The main task of APACS is to manage the major payment **CLEARING** systems in the United Kingdom and to maintain their operational efficiency and financial integrity.

This task is currently carried out by three operational clearing companies. The first is the Cheque and Credit Clearing Company, which oversees the paper clearing. The second is the CHAPS Clearing Company, which provides an electronic same-day clearing in sterling (and, from 4 January 1999, also in euros). The last one is the Banks Automated Clearing System (BACS), which operates the bulk electronic clearing.

L.S. TALANI

Association of Iron Ore Exporting Countries (AIOEC)

Now dormant, the Association of Iron Ore Exporting Countries (AIOEC) was founded in Geneva between 2–3 April 1975 and comprised Algeria, Australia, Brazil, Chile, India, Mauritania, Peru, Sierra Leone, Sweden, Tunisia and Venezuela. It aimed to ensure the orderly and healthy growth of the export trade and to

Association of South-East Asian Nations (ASEAN)

promote social DEVELOPMENT among the member-countries.

JASON P. ABBOTT

Association of South-East Asian Nations (ASEAN)

The Association of South-East Asian Nations (ASEAN) is one of the most successful regional organizations of the THIRD WORLD. It was established in 1967, with five members from non-communist countries (Indonesia, Malaysia, the Philippines, Singapore and Thailand), to ensure each nation's security amid Cold War's ideological conflicts within the region. Its membership was expanded to nine after the inclusion of Brunei (1984), Vietnam (1995), Laos and Myanmar (1997), with the final goal of integrating every country in the region by the year 2000. Cambodia is the only country that is not yet accepted into the group, due to its domestic political instability and violence.

The original objective of ASEAN was to promote social and economic cooperation. In the area of industry, the five governments collaborated under the ASEAN Industrial Projects (AIP) while their private sectors worked together under ASEAN Industrial Complementation (AIC) schemes and ASEAN Industrial Joint Ventures (AIJV). Cooperation in trading started in 1976, under the ASEAN Preferential Trade Arrangement (PTA). The ASEAN FREE TRADE AREA (AFTA) was proposed in 1992 and is to be completed within the year 2003, when tariffs on most products from member-countries will be reduced to 5 per cent or less.

However, ASEAN put higher priority on political than economic cooperation, and has accomplished more in this area. Since its inception, ASEAN was preoccupied with solving intra-group disputes and creating the Zone Of Peace, Freedom And Neutrality (ZOPFAN) during its first decade; it was highly involved in settling the Cambodian

problems during the second decade of its existence. In the post-Cold War era of ASEAN's third decade, newer forms of co-operation in security matters began with the aim of creating a South-East Asian Nuclear Weapon-Free Zone (SEANWFZ), and setting up the ASEAN Regional Forum (ARF) in 1994 as a multilateral security dialogue for Asia-Pacific countries.

ASEAN has gained much international recognition because of its good performance over the past thirty years, and through its outside exchanges and international linkages with major powers and important trading and dialogue partners. When the 'ASEAN-10' goal is achieved with the incorporation of Cambodia, ASEAN can fully be considered the most essential factor for building peace, prosperity, reconciliation and stability in the South-East Asian region, now and in the future.

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CORRINE PHUANGKASEM

ASYLUM SEEKERS *see* refugees

ATLANTIC ALLIANCE *see* North Atlantic Treaty Organization (NATO)

atomism

'Atomism' is an analytical doctrine, which contends that any complex system is an aggregation that is understood through the

study of its constituent parts. Primarily an application of micro-level analysis, atomism examines autonomous actors (such as individual firms or economies) within a larger market structure or economic system.

J. ANDREW GRANT

Austrian School

Most commentators set the birth of the Austrian School of Economics at 1871, with the publication of *Grundsätze der Volkswirtschaftslehre* by Carl Menger (1840–1921). On the basis of this work, Menger joined the faculty of the University of Vienna. Menger, together with the English economist William Stanley Jevons (1835–92) and the French economist Léon Walras (1834–1910), opposed the exaggerated emphasis on cost analysis that was typical of the classical school of economics. Instead, these three economists rediscovered and re-explored a previously neglected theory of consumer behaviour.

In spite of this common area of investigation, essential differences existed between the three. For Jevons and Walras, consumer action was an introduction to price theory. Menger, however, dedicated most of his efforts to the explanation of consumer valuation. To him, price theory became a secondary field of studies. Jevons and Walras used mathematical presentation; Menger applied the literary form of demonstration and vehemently rejected mathematics. His ideas and methods were reinterpreted and reformed by several generations of theorists; his most prominent earlier followers were both Austrians – Eugen von Böhm-Bawerk (1850–1914) and Friedrich von Wieser (1851–1926). Later and contemporary economists influenced by this approach were/are Hans Mayer, Leo Schonfeld-Illy, Paul Rosenstein-Rodan, Ludwig von Mises, FRIEDRICH VON HAYEK, Oskar Morgenstern and Murray Rothbard.

There is a common theme tying together the Austrian economists. They view economics as a tool for understanding how people both cooperate and compete in the process of

meeting needs, allocating resources and discovering ways of building a prosperous social order. Austrians view entrepreneurship as a critical force in economic development, private property as essential to an efficient use of resources and government intervention in the market process as always and everywhere destructive.

The general differences between Austrian and mainstream economics stem largely from the differences in methodological approach:

- 1 Mainstream economists use the scientific method: Austrians reject it, at least for the study of the economy. Instead, they use a pre-scientific method which deduces truths from *a priori* knowledge.
- 2 Mainstream economists make heavy use of statistics; Austrians claim statistics have very little value, because of their extreme limitations.
- 3 Mainstream economists seek to explain human behaviour on many different levels: the individual, the group and so on; Austrians believe that all explanations of human behaviour can be traced back to the individual.

Over the years, the Austrian School has experienced different levels of prominence. It was central to the price-theory debates before the turn of the century, to monetary economics in the first decade of the century, and to the controversy over socialism's feasibility and the source of the business cycle in the 1920s and 1930s (see BUSINESS CYCLES). The school fell into the background from the 1940s to the mid-1970s, and was usually mentioned only in textbooks on the history of economic thought. In recent years, especially in the United States, the school is making something of a comeback, especially after the granting of a Nobel prize to Hayek in 1974. In part, the school's resurgence reflects a backlash against mathematization. To some, however, the Austrian School looks more and more attractive, given the collapse of socialism, the cost and failure of the welfare-warfare regulatory state, and public frustration with big government.

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ROBERT LOONEY

autarky

'Autarky' literally means 'no trade'. Since countries rarely dispense with trade entirely, autarky exists in degrees. As such, the term refers to a nation's desire to attain some measure of domestic self-sufficiency. A national policy based on autarky is therefore looked on as a means of assuring that the nation will not be at the mercy of capricious market forces – that it will somehow be able to shape its own destiny. The literature reflects the diverse meanings or motivations for national self-reliance taken on by the term 'autarky': MERCANTILISM, industrial DEVELOPMENT and fear of global capitalist forces. No doubt for any individual country at any point in time more than one of these motives may be the rationale for implementing a policy of autarky.

The first writers to promote autarky as a goal of national policy were the seventeenth-century European mercantilists. These writers agreed on the desirability of (1) enhanced national power, (2) intervention in economic affairs by the central authority, (3) unification of the country by scrapping internal trade restrictions, (4) a favourable balance of trade and (5) a large population.

One of the issues that distinguished the nineteenth-century mercantilism espoused by ALEXANDER HAMILTON, FRIEDRICH LIST and other national economists from the earlier mercantilist doctrines was its emphasis on the importance of self-sufficiency in armaments. Hamilton believed the United States should be independent of foreign nations for military and

other essential supplies in order to be less dependent on the foreign policies of other states. In addition to armaments, Hamilton and List also advocated protecting a wide spectrum of infant industries during their early stages of development. Presumably these industries could not become established without some form of protection that assured a stable period of profits. The anticipation is that, within some reasonable period, they will become viable without this indirect subsidy, so that the protection is temporary. In this sense, IMPORT SUBSTITUTION is looked on as investment in the future. That is, a temporary loss in efficiency will be more than made up by the creation of a dynamic industrial economy that would not have been possible otherwise.

Soon after World War II, more sophisticated arguments for autarky and import substitution were developed by RAUL PREBISCH (then Director General of the UNITED NATIONS ECONOMIC COMMISSION FOR LATIN AMERICA (ECLA)) and HANS SINGER (with the UN Department of Economic and Social Affairs). Prebisch and Singer argued that the commodity TERMS OF TRADE of countries (mainly developing nations) producing primary goods (food, raw materials, minerals and the like) decline in the long run. The PREBISCH-SINGER HYPOTHESIS states that the terms of trade deteriorated historically because of differences in the growth of demand for and the market structure in primary and manufacturing production. This finding strengthened the arguments for the autarkic import-substitution policies undertaken by the major Latin American countries between 1950 and the mid-1970s (Bruton, 1998).

During the twentieth century, the socialist countries also implemented their form of autarky. LENIN and Trotsky argued in favour of the participation of the Soviet Union in world trade, but they did not regard it as a panacea. Instead, they viewed it as a means of obtaining a temporary breathing space until the victory of the workers in the advanced capitalist countries would come to the aid of the USSR. The Soviet Union then was a very backward country. Trotsky predicted that, as

the Soviet economy developed, it would be forced to abandon autarky and participate more and more in the world economy. Far more important, however, were the political consequences. Lenin correctly insisted on the need to integrate the Soviet economy as much as possible with the world economy, to get the maximum benefit from the world division of labour. The short-sighted Stalinist bureaucracy, however, opted for an autarkic policy that minimized the country's dependence on the world market. National autarkic ambitions dominated Soviet foreign-trade policy up to the time of Stalin's death in 1953.

Other Eastern European states' autarkic attitude towards trade was also conditioned by such factors as the wide fluctuations in capitalist markets to which these countries had been exposed under pre-communist regimes, the hostility of Western countries (including the strategic embargo initiated in 1947) and the desire for industrialization to achieve a balanced economic structure in traditionally agricultural countries. Under these conditions, trade was essentially regarded as a necessary evil to facilitate the industrialization programme, a means of obtaining machinery and other equipment, while exports were looked on as a sacrifice to pay for those products that could be produced domestically only with great difficulty.

Socialist countries in the developing world often subscribed to the argument that their problems of industrialization were the direct consequence of exploitation by the 'imperialist' industrialized world. This world-systems approach, put forward by the Egyptian Marxist economist Samir Amin (1977), resolved that only autarky from the world system would result in the industrialization of the THIRD WORLD.

However, except for a few hard-core countries like North Korea, most of the socialist states' disillusionment with autarky resulted in abandonment of that policy. Even the USSR, which had the greatest potential for self-sufficiency of all the countries of the world, turned increasingly to foreign trade. While part of this shift was for political

reasons, there was a growing realization among socialist leaders that trade represented an important means of economizing resources through international specialization and a channel for the incorporation of the latest technological achievements of the West into the USSR's otherwise unsophisticated industrial structure.

Recent research – carried out by Jeffrey Sachs (Sachs and Warner, 1995), Bella Balassa (1985) and others – documents the forces moving countries away from autarky. During 1970–80, Sachs found a strong association between openness and growth, both within the group of developing countries and the group of developed countries. Within the group of developing countries, the open economies grew at 4.49 per cent per year and the closed (more autarkic) economies grew at 0.69 per cent per year. Within the group of developed economies, the open economies grew at 2.29 per cent per year and the closed economies grew at 0.74 per cent per year.

Focusing on growth within open and closed groups, another interesting pattern emerges. Within the closed group, average growth was about the same for the poorer developing countries (0.69 per cent) as for the richer developed countries (0.74 per cent). However, within the group of open economies, the developing countries grew faster (4.49 per cent) than the developed countries (2.29 per cent). This suggests that within the group of open economies, both developing and developed, we should observe economic convergence as predicted by neo-classical economics (Barro, 1992) – that is, a movement away from autarky is a precondition for closing the gap between developing and developed countries.

See also:

industrialization strategies; neo-mercantilism

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authoritarian states

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ROBERT LOONEY

authoritarian states

An 'authoritarian state' is a form of political rule or government based on authority rather than on consent, in which the dominant interests are enforced foremost by violent physical means.

The most characteristic features of an authoritarian state are its lack of separation of powers and its arbitrariness. The authoritarian state is highly bureaucratized and militarized, with a strong centralized power structure. Different types of authoritarian states can be distinguished: a bureaucratic authoritarian state; a populist authoritarian state; or a military authoritarian state. These distinctions are important to highlight the differences between certain authoritarian regimes, where power is either in the hands of a dictatorial leader or a group coalition.

Another main characteristic of the authoritarian state is its developmental tendency towards interventionism in the economy. Historically, this form of the state took place in economically late-industrializing and backward regions and countries. By state intervention, the state tries to catch up with the advanced capitalist countries through a revolution (or modernization) from above, which might be seen as the capital accumulation of an unintended social transformation resulting from above (Moore, 1966, 1987; Trimberger, 1978; Amineh, 1999).

According to Barrington Moore (1966, 1989), in the transition process from an agrarian society to an industrial society, the authoritarian state took hold in those countries where no popular bourgeois revolutionary upheaval took place. This was the case in Germany – the Stein–Hardenberg Reforms in Prussia (1807–14), Bismarck's Unification (1860s) and the fascist period (1933–45) – and in Japan – the Meiji Restoration in the late nineteenth and early twentieth century. Seventeenth-century England, eighteenth-century France and the nineteenth-century United States took a democratic route towards industrialization by the presence of a 'strong' bourgeois impulse. In Germany of the late nineteenth and early twentieth century, the upcoming bourgeoisie and the land-owning class who saw its economic basis decline because of greater world trade competition, formed a political coalition to prevent peasant upheavals and support industrialization by authoritarian rule.

According to Malloy (1977), authoritarian regimes in Latin America after World War II were grounded in a structural political and economic crisis. Parts of the middle class, who had been supporters of the former oligarchic system, came to the forefront of political struggle but were not able to put through any structural transformation. To keep their position, they formed a populist multi-class coalition that was powerful enough to gain control of the state and attempt a structural transformation from above.

A characteristic feature of most authoritarian states of the twentieth century was their corporatist organization. CORPORATISM is an organizational form of the state that expresses itself in specific relations between state, labour and capital. It is characterized by a distinctive state intervention in economic activities. Two main forms of corporatism can be distinguished: 'social corporatism' and 'state corporatism' (Schmitter, 1974). Social corporatism is a form of organization of the state in industrialized countries by which the state gains the position of an active agent for economic policy, mediating between labour and capital.

Social corporatism was characteristic of developed countries in Europe after World War II, which combined it with Keynesian demand-management (see KEYNESIAN ECONOMICS). State corporatism is a characteristic feature of authoritarian regimes in late-industrializing countries, where labour conflicts remain acute and polarized as the bourgeoisie is too weak to achieve a social hegemony. In this organizational form of the state, the state apparatuses are in the hands of a political leadership that rules over capital and labour. By the imposition of repressive political force from above, the state promotes industrialization. State corporatism was characteristic for states with an authoritarian regime in the 1920s and 1930s, and revived after World War II to a greater extent in many developing countries. Examples of authoritarian regimes in the twentieth century with a state corporatist organizational form were Germany under Hitler (1933–45) and Italy under Mussolini (1922–43); Argentina under Juan Domingo Perón (1943–55), or the regime of the Shah in Iran (1962–77).

Various concrete forms of authoritarian states over the last 200 years have been specified by ROBERT W. COX (1987) in the context of a specific structure of the world order: in the age of *PAX BRITANNICA* (the eighteenth to nineteenth century), in France under Louis Bonaparte (Bonapartist state form), in the age of rival imperialisms (the end of the nineteenth to the beginning of the twentieth century), in Germany under Bismarck (welfare nationalist state form), in Germany and Italy (fascist state form), in the age of the *Pax Americana* (mid-twentieth century) and in late-developing Third World countries – for example, Argentina and Brazil (neo-mercantilist developmental states form). The neo-mercantilist developmental state form can be considered the characteristic form of the state of a number of developing countries after World War II. Here, state corporatism built the organizational form of the state.

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MEHDI PARVIZI AMINEH

automobile industry

The automobile industry has historically had a close link to the STATE due both to its economic importance and to the car's symbolic status as a source of freedom and liberty. In recent years, this link has been subjected to

considerable strain: international organizations such as the EUROPEAN UNION (EU) and the WORLD TRADE ORGANIZATION (WTO) have intervened to prevent anti-competitive practices in the sector; knowledge has increased of the effect of road vehicles on the environment and it has become clear that, globally, governments cannot keep pace with projected traffic growth. Consequently, the automobile sector faces an uncertain future in which government policy must seek to balance the positive associations of the car with its negative connotations.

The automobile industry's close association with the state has in many polities taken on a clientelistic character (see CLIENTELISM). Under such circumstances, the pro-roads groups have typically been well organized, enjoying frequent contact with government officials as part of an integrated policy community.

This close association has developed for both economic and value-based reasons. Historically, the automobile industry was very important to the economy of many industrialized capitalist states, acting as an important spur to the process of mass production and early industrialization, as can be seen particularly in both the United States (with the development of the *Model T Ford*) and in Germany in the 1930s (with the development of the Volkswagen – which translates as 'people's car'). Historically, the industry has also been very important for national security, capable of being used to meet military requirements in both World War I and World War II, which further strengthened the sector's links with the state.

This symbiotic relationship between the state and the automobile sector persisted in the post-World War II era for a number of reasons related to the nature of the car industry itself: its size in terms of output, employment and investment; its importance in terms of world trade and the BALANCE OF PAYMENTS; its high visibility in the marketplace and in terms of the labour market, and (until recently) because it has been seen as an important facilitator of ECONOMIC GROWTH.

The automobile industry's close relationship with the state is also based on its core values (such as its links with freedom and liberty) which have been traditionally associated with CAPITALISM. A powerful ideas orthodoxy thus developed, maintaining that:

- 1 roads are essential for economic prosperity, as they enable the free movement of produce and the expansion of the macro-economy;
- 2 transport policy ought to be market-based, responding to the demands of transport consumers, and that policy should pay only minimal attention to the impact of external costs such as congestion, accidents or environmental effects (EXTERNALITIES).

Economic growth was perceived to be linked to growing transport mobility: a primary function of government was thus to provide sufficient INFRASTRUCTURE to facilitate economic growth.

This combination of the perceived economic importance of the automobile sector and the compatibility of its values with those of the state has meant that the automobile industry has been able to benefit from what Dowding (1991) has termed 'systematic luck'. Dowding argues that capitalists benefit from systematic luck as governments are dependent on high levels of economic activity both for their revenue and as an important source of electoral legitimacy. The car industry, with its close link to economic development and to the ideas orthodoxy of the capitalist state, has thus been lucky in that its interests have historically coincided with those of government.

However, since the late 1980s, the close association between the automobile industry and the state has come under increasing strain. First, international organizations such as the WTO and the EU have become increasingly active in attempting to reduce the anti-competitive practices which have hitherto been the norm within the sector. On one hand, particular attention has focused on removing national QUOTAS, TARIFFS and barriers in order to increase international trade in automobiles. On the other, the EU in particular has sought

to reduce levels of state aid in the sector, formally breaking down the clientelistic relationship between the state and the car industry. A number of mergers and takeovers, consolidating the industry, have resulted as the increasing competition and GLOBALIZATION of the industry has highlighted its overcapacity; such mergers across national boundaries serve to further weaken the links between state and industry.

This relationship has been further eroded as transport (and particularly the motor car) has come to be identified as a policy problem for governments. Since the early 1990s, the motor car has increasingly come to be blamed for a combination of economic and environmental problems. On one hand, the problems associated with the car such as congestion, its impact on land-use and noise pollution have become more serious. On the other hand, both expert and public knowledge about the environmental effects of transport has increased significantly: this has in part helped to raise awareness of a series of new policy problems, such as GLOBAL WARMING. In response to such developments, governments across the industrialized world have increasingly acknowledged that it is essential to restrict the access of citizens to the car and reduce total car use.

Thus governments increasingly face significant challenges surrounding the politics of the automobile industry: how can they both accommodate the perceived benefits of the car (the jobs, freedom and values that it exemplifies) while reducing the costs associated with it (in particular, the environmental and congestion-related costs).

See also:

corporatism; environmental impact of projects; industrialization strategies; liberalization of trade; national champions

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NICK ROBINSON

automobilization and motorization

The concept of 'motorization' refers to the integration of motorized vehicles, including private cars and commercial vehicles, into society. In the twentieth century, motorization became an important aspect of modern societies and the constant increase in motorized transport was a global megatrend.

'Automobilization' refers to the way cars are integrated into society and appropriated by the individual. It is a part of motorization and synonymous with the progress of automobility. The concept of 'automobility' is used to distinguish the use of cars and the related complex (consisting of social, cultural and economic relations) from the use of other heavy and light vehicles. The private car is a well-known symbol for social progress.

The progress of automobility has resulted in a built-in and structural dependency on privately owned cars for transportation of goods and people. According to a prognosis made by the ORGANISATION FOR ECONOMIC CO-OPERATION AND DEVELOPMENT (OECD), approximately 560 million cars will have been registered by the year 2000. Thus about 9 per cent of the global population has a car. The degree of motorization in developing countries is roughly 75 motor vehicles as per 1,000 inhabitants today. Of course, huge intraregional

autonomous development

differences are masked by such estimations of the average.

Automobility is a large technological infrastructure consisting of drivers, vehicles, roads, systems for fuel provision, services and so on. Motorization represents (1) a technical infrastructure for transport of goods and people, and (2) the capability to provide a market in which ECONOMIC GROWTH can be sustained.

Cars as technical artefacts have the same technical and physical characteristics wherever they are driven. Automobility, on the other hand, appears in a wide variety of forms, corresponding to geographical, social, cultural, political and economic differences. Consequently, the dynamics involved in automobility vary according to the prevailing perspective on societal development.

The automobilization of domestic economies and household economies, together with the values inherent in the Fordist technoeconomic paradigm, tend to enlarge markets and sustain economic growth. The production and use of cars are thought to be a 'motor' of national development in times of economic expansion, as it requires the establishment of a large and necessary infrastructure and uses tools necessary for the development of markets.

The NATION-STATE system is being relativized by the evolution of political and economic relations linked together by phenomena such as automobilization. Being the first globalized industry and a carrier of intensified GLOBALIZATION, the automotive industry was thought to have the capacity to push the state closer to the world market. Automobility can be an important part in the state-market relation: most countries are sensitive to changes in the development strategy concerning motorization, automobilization and issues of transportation.

Commercial vehicles and private cars are usually produced by the same economic actors, but their social and economic functions are different at critical points – such as the economic activities related to consumption. The appropriation of individual and family needs, and the role of cars in the household

economy differs from the use of commercial and heavy vehicles.

The emergence of the international political economy (IPE) of automobilization and motorization during the second half of the twentieth century was a result of growing structural dependency on private (and commercial) motorized transport and awareness of environmental degradation. Four problems associated with motorized transport seem particularly difficult to solve: (1) increasing congestion in densely populated areas, (2) the high number of road deaths and injuries, (3) increasing impact on local, regional and global ecological systems, and (4) growing uncertainties about the future fuel supply for the rapidly increasing fleet of motor vehicles.

MARIE THYNELL

autonomous development

The expression 'autonomous development' gained wide currency alongside dependency and WORLD-SYSTEMS THEORY in their heyday from the mid-1960s to the early 1980s. With the rise of NEO-LIBERALISM, the increasing GLOBALIZATION of the world economy and the demise of socialist economies, use of the term has diminished. In dependency and world-systems theory, the world is divided between centre/periphery and SEMI-PERIPHERY (see CORE-PERIPHERY MODEL). A centre or developed country (DC) is defined as having the ability to exercise a high degree of control over its economy, while the periphery's development process is shaped by external events, largely originating from the centre countries. Thus, the centre country pursues a relatively autonomous development path, while the periphery can only follow a dependent development path. This dependency relationship perpetuates UNDER-DEVELOPMENT, distorts and even blocks the development process of the periphery or LESS-DEVELOPED COUNTRY (LDC).

It is important not to confuse autonomous development with AUTARKY. Autonomous development does not imply lack of economic

and further links with other countries. Rather, it refers to the ability of a country to control its own development process without undue interference from and **DEPENDENCE** on outside economic forces. An autonomous development strategy is concerned with inner-directed development or development from within, meaning that the network of external linkages are determined from within the **LDC** itself. With autonomous development, a national or regional economy aims to subordinate external relations to the needs of internal accumulation, production and interests. Autonomous development implies relative independence of decision-making, invokes a certain degree of introversion and a self-generated development which caters for external markets only in so far as internal needs and interests require it.

The lack of autonomous development in **LDCs** is the outcome of a process of history, and closely linked to the emergence and spread of **CAPITALISM** throughout the world. This created a new division of labour and production in which the **DCs** (by virtue of their industrial development) became exporters of manufactured commodities, while the **LDCs** became producers and exporters of primary commodities (such as plantation crops and mineral products) and importers of industrial commodities. This international **DIVISION OF LABOUR** was reinforced through **IMPERIALISM** and **COLONIALISM**. Thus, prior to the onset of **DECOLONIZATION** after World War II, many **LDCs** were both economically and politically dependent.

Technological progress (the ability to produce more output with the same amount of inputs) increasingly became the main determinant of growth in the **DCs**. **TECHNOLOGICAL CHANGE** is achieved by using more machines, building better machines, and improving the organization of the production and distribution processes. A distinction is usually made between capital goods (machines and tools), **INTERMEDIATE GOODS** (products – such as steel and chemicals – which are used as raw materials by other industries) and consumer goods. **LDCs** have few manufacturing industries and those they do have are confined to

producing mainly consumer goods, some intermediate goods and few capital goods. The production of capital goods requires sophisticated technology, high levels of engineering skill and considerable capital, given the capital-intensive nature of the production process. All these are factors which are generally not found in **LDCs** and which are used to best advantage by the **DCs**. The advantage of having a sizeable capital-goods industry is that it produces the machines and tools that are the main source of technological progress and thus of increases in productivity. It is this rise in productivity which constitutes a major source of **ECONOMIC GROWTH**, particularly as economies develop.

The problem for **LDCs** is that their lack of a significant capital-goods industry deprives them of this major source of economic growth. The export sector thus acquires a vital importance, as it is only by earning **FOREIGN EXCHANGE** through exports that **LDCs** can afford to import the tools and machinery which will lead to technological progress and fuel future economic growth. This puts **LDCs** in a vulnerable position. Given that their foreign exchange earnings fluctuate due to the instability of primary commodity prices on the world market, they cannot always afford to purchase the spare parts or intermediate goods required for keeping the machines working. More significantly, they are deprived of the positive spin-offs that a capital-goods industrial sector generates through its multiple dynamics linkages to the rest of the economy (see **HIRSCHMAN, ALBERT O.**). In short, the process of capital accumulation is restricted and vulnerable in **LDCs**, linked as it is to their foreign exchange earnings. It is also dependent, as the advanced technology is controlled by **MULTINATIONAL CORPORATIONS (MNCs)** and **DCs**. These are the key factors which explain the lack of autonomous development of **LDCs**.

From this it follows that for **LDCs** to achieve autonomous development it is necessary to industrialize and build a capital-goods sector. The structuralist dependency theorists argue that reforming the world economic order through trade negotiations, better and more stable prices for primary commodities, greater

autonomous development

control over the activities of MNCs and internal reforms within the LDCs, will reduce LDC dependence and enable a certain degree of autonomy (see **STRUCTURALISM**). By contrast, the Marxist dependency theorists argue that it is only by **DELINKING** and initiating a transition path to socialism that it will become possible for LDCs to generate an autonomous development process.

As globalization engulfs even the most remote corners of the world, it appears utopian to seek autonomous development. But, although the world economy has become increasingly interdependent, it is a highly unequal and uneven **INTERDEPENDENCE**. It could be argued that LDCs are structurally interdependent, while the DCs enjoy relative autonomy within this interdependent relationship. It is the DCs, regional groupings such as the **EUROPEAN UNION (EU)** and, increasingly, the MNCs tied to specific DCs, that shape and determine these interdependent relationships. Countries and entire regions (such as **SUB-SAHARAN AFRICA**) are at the mercy of the dominant economic forces, and are marginalized from all key processes and decisions that determine changes in the world economy and polity. Even worse, since the **DEBT CRISIS** of the 1980s, many African countries have become highly dependent on foreign **AID** and finance, and international institutions like the **WORLD BANK** have exerted much influence over their internal affairs. The battle-cry for self-reliance and autonomous development of the liberation movements in many **THIRD WORLD** countries in the wake of decolonization has been cruelly transformed into one of dependence and marginalization as a result of globalization, compounded by internal policy mistakes made by the newly independent states.

The concepts of autonomy and dependence have been criticized for implying that the process of development in the DCs is economically independent, self-centred and self-sustaining. Many critics prefer to speak of relations of interdependence and dominance, rather than of dependence. Given that it is impossible to achieve a state of non-dependence, they prefer to speak of degrees of

dependence in an interdependent world. Some even argue that, in recent decades, economic power has become more dispersed among the DCs and the relative bargaining-power of LDCs has improved, especially since the rise of the **NEWLY INDUSTRIALIZING COUNTRIES (NICs)**. Thus, many developing countries now enjoy greater freedom of manoeuvre than in the past. While the interdependence between DCs and LDCs has increased, the LDCs have become less subordinate in the relationship. Some opponents of the autarkic strand of some versions of dependency theory even assert that increased economic interaction between DCs and LDCs is a precondition for genuine equality between interdependent economies.

Structuralist dependency authors specify some general policy measures to reduce the ties of dependence and move towards autonomous development in LDCs. These include economic **INTEGRATION** between LDCs, measures to regulate the activities of MNCs while encouraging them to engage in **TECHNOLOGY TRANSFER** and re-investment, and measures to reform the international economic system by establishing a **NEW INTERNATIONAL ECONOMIC ORDER (NIEO)**. Marxist dependency writers, by contrast, have few policy recommendations beyond calling for the overthrow of capitalism and the establishment of socialism. Other radical thinkers propose a strategy of alternative, autocentric, self-centred or self-reliant development, which involves selective dissociation and delinking, but also relinking in a way which enhances autonomous development.

See also:

compradors; Galtung, Johan; world system

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average propensity to save (APS)

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CRISTÓBAL KAY

average propensity to consume (APC)

The average propensity to consume (APC) is the ratio of consumption to disposable income at a certain moment for an individual, group or society. In the situation of very low income, the APC amounts to more than 1.0: consumption exceeds disposable income. This means that

savings are negative; people borrow money to be able to buy their necessary consumer goods. As disposable income rises, the APC decreases and becomes less than 1.0.

By contrast with the MARGINAL PROPENSITY TO CONSUME (MPC), which has a constant value, the APC can vary, starting from zero.

N.M. DUYKERS

average propensity to save (APS)

The average propensity to save (APS) is the ratio of saving to disposable income at a certain moment for an individual, group or society. In the situation of very low income, the APS is negative: people do not save, but instead borrow money to be able to buy their necessary consumer goods. As disposable income rises, the APS increases and becomes positive.

By contrast with the MARGINAL PROPENSITY TO SAVE (MPS), which has a constant value, the value of the APS can vary and be negative, zero or positive.

N.M. DUYKERS

B

backwash effects

'Backwash effects' are negative economic and social impacts on a periphery (usually rural) economy because of growth in a core (usually urban) economy. Examples include government spending on core infrastructure at the periphery's expense, periphery depopulation due to migration to the core, attendant shortages of labour (especially educated and skilled labour), drain of capital from the periphery to the core, and loss of markets (usually local) to core competitors (such as core hospitals providing more advanced medical services that draw an increasing share of periphery business). The concept can relate to relationships at the international level (with developed nations as the core and developing nations as the periphery) and the national level (with, for example, the old US manufacturing belt as core). However, the concept is probably most appropriate at the regional level (with a city as a core and its hinterlands as a periphery).

In this context, much of the debate has centred on whether backwash effects dominate the polar opposite spread effects (the positive impact of the core on the periphery). GUNNAR MYRDAL argued that backwash effects generally dominate; ALBERT HIRSCHMAN, however, felt that backwash effects are initially high as resources are pulled into the urban core, but they diminish over time as the regional economy becomes spatially disaggregated. More recently, Paul Krugman has argued that the core develops by obtaining a critical mass of workers (consumers) based on some early advantage. Once a critical mass is obtained, a cumulative process of core growth may ensue at

the expense of the periphery (see Krugman, 1991).

A spate of recent work has attempted to examine the strength of backwash effects. David Hughes and David Holland (1994) argued that backwash effects may be occurring in the Washington State economy, as banking and other services in the Seattle area gain market-share in the periphery. David Senf (1989) suggests that the linkages from core to periphery areas may be strengthening as retail trade and service-oriented activities take advantage of specialization and economies of size by shifting from rural to urban areas. Some researchers have attempted to associate absolute declines in periphery economic activity with core economic growth. David Barkley and his associates found that, for three urban core and rural periphery regions (known as Functional Economic Areas or FEAs) in the state of South Carolina, growth at the urban fringe was associated with depopulation in isolated rural areas at the periphery. For other FEAs in the state, core growth was associated either with periphery stagnation or with periphery growth (Barkley, Henry and Bao, 1994).

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Baker Plan

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DAVID HUGHES

Baker Plan

The Baker Plan was an attempt to resolve the international debt crisis and avert a collapse of the international financial system in the aftermath of Mexico's default in 1982. Associated with the name of US Treasury Secretary, James A. Baker III, it was announced at a joint meeting of the INTERNATIONAL MONETARY FUND (IMF) and the WORLD BANK in Seoul in South Korea in October 1985.

The plan focused on seventeen debtor countries, mostly in Latin America. It followed several years of austerity measures under IMF STABILIZATION POLICIES. The plan proposed more of the same policies, with the involvement of the World Bank as well as the IMF, but it added an emphasis on economic growth in addition to stabilization and adjustment. An important feature of the plan was the promise of additional finance through the World Bank and the INTER-AMERICAN DEVELOPMENT BANK (IDB), and pressure on the commercial banks to increase their lending to heavily indebted countries by US\$20 billion over the successive three years. Some multi-year restructuring of debt already had been agreed before the start of the Baker Plan and the years immediately after the Baker Plan saw a variety of new restructuring agreements.

The Baker Plan was more concerned with saving the banks than solving the development problems of debtors, and was superseded by the BRADY PLAN in 1989.

See also:

debt crisis

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JOHN THOBURN

balance of payments

The balance-of-payments accounts record all the financial transactions between the residents of a country and those in the rest of the world during a specified accounting period, usually a year. Conventionally, the balance of payments is divided into the current and capital accounts. The current account includes the receipts and payments for exports and imports (the visible items), the net figure being the BALANCE OF TRADE. It also includes the invisibles – namely, the balance for services, net payments of interest, profits and dividends, and unilateral transfers (international grants and remittances from expatriates).

Unlike the current account, the capital account affects the net wealth of a country as it involves the acquisition or surrender of claims on foreign residents. The capital account includes direct investment and portfolio investment. Direct investment is where there is direct control of the purchased asset. An example is the case of a foreign company building a subsidiary plant in a country. PORTFOLIO INVESTMENT consists of the acquisition of equities, bonds issued by the foreign government and loans. This is divided into short-, medium- and long-term investments. The purchase of an overseas asset by a domestic resident appears as a negative item in the balance-of-payments accounts.

As an accounting identity based on double-entry bookkeeping, the balance of payments necessarily balances, so any difference between the current account and net flows of direct and portfolio investment will be financed by changes in the official reserves, subject to a balancing item that records any errors and omissions in the accounts.

However, economists have typically paid special attention to imbalances within the balance-of-payments accounts. A distinction is sometimes made between 'autonomous' and 'accommodating' items. The former are items which are determined independently of other components of the balance of payments, while accommodating items respond to changes in the autonomous components. If, for example, the competitiveness of exports declines for some reason and the current account moves into deficit, this may be accommodated by short-term capital flows induced by the government raising interest rates. Thus, the term balance-of-payments deficit is often used to refer to a current account deficit. However, sometimes long-term capital flows are regarded as autonomous, and the sum of the current account and net long-term capital flows is termed the basic balance. Nevertheless, it is somewhat arbitrary to distinguish between short-term and long-term capital flows, and the basic balance as an operational concept has fallen out of favour. An alternative approach is to regard the accommodating flows as the changes in reserves; this is known as the 'official settlements concept'. It has not been used in the United Kingdom since 1985 because, under a FLOATING EXCHANGE RATE, the monetary authorities' use of reserves was seen at the time as being greatly reduced (although there has been considerable subsequent use of reserves to try to stabilize the EXCHANGE RATE). These transactions have now been recorded elsewhere in the balance-of-payments accounts.

Whether or not a current account deficit is a cause for concern depends on the underlying assumptions made about the functioning of the economy. The absorption approach to the balance of payments sees a current account deficit as reflecting the excess of national expenditure over income. Since it is not possible to run a current account deficit indefinitely, it will be necessary to service the deficit and eventually repay the principal. To correct the current account deficit, it is necessary to introduce expenditure-reducing (deflationary) policies, together with expendi-

ture-switching policies (a currency devaluation or depreciation – see CURRENCY DEPRECIATION; DEVALUATION, CURRENCY). If the cause of the current account deficit is the uncompetitiveness of exports and expenditure-switching policies are ineffective, the burden of adjustment falls entirely on income and this will lead (in a dynamic context) to BALANCE-OF-PAYMENTS CONSTRAINED GROWTH. In these circumstances, the current account deficit is seen as reflecting an underlying weakness in the country's production of tradeable goods and services.

In the monetary approach to the balance of payments, output is determined exogenously in the long run. The assumption of the law of one price is invoked (that is, the price elasticity of demand for exports is infinite) and so the current account cannot present a problem in the long run. Rather, the monetary approach stresses the disequilibrium between the demand for and supply of the money stock as the cause of a (temporary) balance-of-payments deficit.

See also:

capital, internationalization of; foreign exchange

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J.S.L. McCOMBIE

**balance-of-payments
constrained growth**

The economic growth of a country is said to be 'balance-of-payments constrained' if its performance in external markets, and the response of the world financial markets to this performance, constrain the growth of the economy to

balance-of-payments constrained growth

a rate that is below that which internal conditions (such as the rate of unemployment and the potential rate of investment) would warrant. In the United Kingdom in the 1950s and 1960s, this was reflected in 'stop-go' policies by which consumption-led booms were brought to an abrupt end by balance-of-payments crises. Consequently, the trend rate of growth of a balance-of-payments constrained country is largely determined by the performance of its exports and is less than the growth of its potential GROSS DOMESTIC PRODUCT (GDP). A country cannot grow indefinitely faster than its balance-of-payments equilibrium rate to the extent that the increasing current account deficit, which is financed by accommodating short-term capital flows, causes the ratio of the net stock of foreign debt to GDP to grow continuously.

A low balance-of-payments equilibrium growth rate means that investment is discouraged, unemployment (either open or disguised) increases, technical progress is reduced and the country's goods become less desirable compared with those of its foreign competitors. This leads to a further worsening of the balance-of-payments position and the danger of cumulative decline. The converse will occur for a country with an initially rapid growth of exports.

There has been extensive discussion as to whether or not a balance-of-payments constraint can be relieved by a flexible EXCHANGE RATE. One interpretation of the recent experience suggests that while a devaluation or depreciation can temporarily improve the BALANCE OF PAYMENTS for any given growth rate, it is ineffective in allowing the trend growth rate to increase. There are two main related reasons for this. First, it is difficult for a nominal depreciation to be converted into a real depreciation if there is inflationary feedback from higher import prices to higher domestic prices because of real wage resistance. (This is where labour seeks and gains increased money-wage increases to offset the rise in the price level consequent to the depreciation.) This is a distinct possibility if, as is likely, an increase in the trend rate of growth requires a

continuous depreciation of the currency. Second, the fact that much trade – especially in manufactured goods – is subject to PRODUCT DIFFERENTIATION, suggests that the price elasticities are low. Thus, the MARSHALL-LERNER CONDITION may only just be satisfied, so that a substantial (and sustained) rate of depreciation is required, which is unlikely to occur. A corollary of this is that non-price competitiveness (a function of the quality of products and so on) is more important in international trade than price competitiveness.

A.P. Thirlwall has shown, using a Keynesian model, that the balance-of-payments constrained growth rate is given by the expression, $y_\beta = \varepsilon w / \pi = x / \pi$, where ε is the world INCOME ELASTICITY OF DEMAND for the country's exports and π is the domestic income elasticity of demand for the country's imports. w and x are the growth of world income and exports. There are substantial disparities between the values of ε and π for the advanced countries, which represent differences in non-price competitiveness. This rule of growth has become known as Thirlwall's Law and represents the workings of the dynamic Harrod foreign trade multiplier (see MULTIPLIER, FOREIGN TRADE) or, more generally, the dynamic Hicks super-multiplier. The law provides a theoretical rationale for the EXPORT-LED GROWTH theory, which stands as an alternative to the neo-classical theory of growth (see NEO-CLASSICAL ECONOMICS).

There have been a number of studies testing Thirlwall's Law and it is found that the growth rate of many countries closely approximates to y_β , the values of which can greatly differ. This suggests that the growth of many countries is balance-of-payments constrained and that, generally, the rate of relative price changes and the growth of capital flows are not important in relaxing the balance-of-payments constraint in the long run.

An implication of this approach is that the economic performances of the various TRADE BLOCs are inextricably linked through trade flows. If, as occurred in the mid-1970s, a group of countries reduce their growth rates in a putative attempt to curb inflation, this will lead

to a reduction in their growth of imports from other countries. This will cause the latter countries severe balance-of-payments problems unless they likewise curtail their growth rates, as has inevitably been the case.

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J.S.L. McCOMBIE

balance of trade

The balance of trade is an item in the BALANCE OF PAYMENTS accounts and is the difference between the value of a country's exports and imports of goods. In the United Kingdom, this is known as the 'balance of visible trade', in contrast to the 'balance of invisible trade' which refers to services. If exports exceed imports, residents are receiving more than they are paying to foreigners and the trade balance is said to be in surplus. If imports exceed exports, there is a trade deficit. Exports are usually shown in the accounts as FREE ON BOARD (F.O.B) (that is, excluding transportation costs once the goods have left the country). Imports are valued including COST, INSURANCE, FREIGHT (C.I.F). Whether or not a currency devaluation or depreciation (see CURRENCY DEPRECIATION; DEVALUATION, CURRENCY) will improve the balance of trade is given by the MARSHALL-LERNER CONDITION.

J.S.L. McCOMBIE

balanced growth

Balanced growth advocates, such as Paul Rosenstein-Rodan (1943) and Ragnar Nurkse (1952), have argued that countries have to

develop a wide range of industries simultaneously if they are to succeed in achieving sustained and rapid growth. The origins of balanced growth theory can be traced back to SAY'S LAW (1803), which states that supply creates its own demand. This was modified by JOHN STUART MILL later in the nineteenth century, when he argued that *particular* goods create *particular* demands, but not ones that necessarily balance.

This view was re-emphasized in the context of the depression of the 1930s by JOHN MAYNARD KEYNES, who pointed out that people might want to consume but had to have the income to make their demand effective. The arguments of both Mills and Keynes stressed that, for supply to match demand, investment has to be matched to the goods likely to be demanded. Thus goods with high growth in demand because of high INCOME ELASTICITIES OF DEMAND need high investment. Thus, in any particular economy, there was a need for balanced growth. It was in this context that Rosenstein-Rodan, writing about eastern Europe, suggested that what was needed for economic development was a big push of industrial investment. The implication was that a national economy required the government to direct and promote investment to achieve such a push.

The neo-liberal argument was that, in economies open to international trade, the need for balance at the national level was less acute (see NEO-LIBERALISM), but the depression of the 1930s cast doubt on the efficacy of markets. This, together with the break-up of colonial empires after World War II and the creation of independent nation-states, gave an impetus to planning and coordination at the national level. A further impetus was given by pessimism about the trade prospects for poorer countries. Thus Ragnar Nurkse, writing in 1952, assumed that the export demand for the industrial output of poor countries would be weak and that, therefore, the need for balanced growth within poorer countries was acute.

Thus we have the situation where the uncertainties of international markets, and the loss of ECONOMIES OF SCALE and specialization

Bandung Conference

associated with national AUTARKY, are contrasted with the possibilities of balanced growth at the national level. Some sort of compromise between these two extremes was advocated by Rosenstein-Rodan, who suggested that regional development through CUSTOMS UNIONS (CUs) might combine some gains from specialization and from economies of scale, with some gains from coordination at the regional level.

See also:

Hirschman, Albert; terms of trade

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CHRIS EDWARDS

Bandung Conference

The Bandung Conference, convened in Indonesia in April 1955 by five Asian nations and attended by twenty-nine newly independent Afro-Asian countries, was a landmark in the history of SOUTH–SOUTH cooperation. Many towering leaders of the anti-colonial struggle participated, focusing on the economic DEVELOPMENT of their peoples, which was to be achieved through cooperation among countries of the SOUTH. Support for ongoing anti-colonial struggles was expressed. A collective effort to persuade the Western powers to consult them on decisions affecting them, Bandung sowed the seeds for the foundation of the NON-ALIGNED MOVEMENT (NAM) in 1961.

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D. PARTHASARATHY

Bank for International Settlements (BIS)

The Bank for International Settlements (BIS) was founded at the Hague Conference in 1930 and is the world's oldest international financial organization. Owned and controlled by central banks, it is an important forum for international monetary and financial cooperation between central bankers and other regulators and supervisors. At its general meetings, forty-five central banks have rights of representation and voting. A significant portion of the world's FOREIGN EXCHANGE RESERVES is held on deposit with the BIS. Its predominant tasks are to promote the cooperation of central banks and to provide additional facilities for international financial operations. It has business and other relations with considerably more than its shareholding central banks, however, because some 120 central banks and international financial institutions use the BIS as a bank. The BIS also acts as agent or trustee in connection with various international financial agreements.

The progressive GLOBALIZATION of financial markets led to the establishment (in 1971) of a standing committee of the central banks of the GROUP OF 10 (G-10) major industrial countries. This committee deals with a series of questions, such as the implications of international debt problems, financial innovation, the evolution of financial market structures and the collection of new statistical information. The BIS also provides for the secretariat of the BASLE COMMITTEE ON BANK SUPERVISION, which encompasses three main areas: (1) it provides a forum for discussion on the handling of specific supervisory problems; (2) it coordinates the sharing of supervisory responsibilities among national authorities in respect of banks' foreign establishments with the aim of ensuring effective supervision of banks' activities world-

wide; (3) it seeks to enhance standards of supervision, notably in relation to solvency, so as to help strengthen the soundness and stability of international banking. Moreover, the BIS provides the secretariat for the Committee on Payment and Settlement Systems and its various working parties. This committee reviews developments in payment and settlement systems and monitors developments relating to cross-border and multilateral netting schemes.

The Banking Department of the BIS carries out a wide range of banking operations, which arise from its role of providing financial services to assist central banks in the management of their external reserves. The substantial size of the BIS's balance-sheet total reflects the importance of its functions as banker to central banks. Because a high proportion of the reserve assets which central banks hold in the form of deposits with the BIS needs to be available to them at rather short notice, the BIS's employment of these resources focuses on maintaining a high degree of liquidity. Most of these funds are placed in the market, mainly in the form of investments with top-quality commercial banks and purchases of short-term government securities. While these operations constitute the bulk of the BIS's business, it also conducts a range of foreign exchange and gold operations on behalf of its customers. In the past, the BIS has performed various functions as trustee, fiscal agent or depository with regard to a number of international loan agreements, but the emergence of a united Europe has diminished the significance of this role.

M. PETER VAN DER HOEK

BANK OF ENGLAND *see* central bank
independence

Baran, Paul (1910–64)

Paul Baran was a tenured professor at Stanford University. In addition to a series of influential articles in the *Monthly Review*, his main works

(*The Political Economy of Growth*, 1957; *Monopoly Capital*, with Paul Sweezy, 1966) established him as perhaps the leading Marxist economist in the United States during the 1950s and early 1960s. *Monopoly Capital* expresses the central model of the US Marxist School and was the major scholarly influence on the radical political economists who emerged in US academic life in the decade after its publication.

Baran's work focuses on the limitations of the capitalist model in two different contexts: developing countries and the more advanced industrial nations. With regard to developing countries, Baran (1957) laid the foundations for much of the modern Marxist analysis of development and underdevelopment. Partially drawing on his experiences in Guatemala, Baran's contention was that imperialism created a class structure which blocked the development process in the periphery. He argued that the domination of society in the poor parts of the world by an alliance between local elites and international capital assured that the economic surplus would not be used to promote accumulation in those areas; instead, the surplus would either be squandered unproductively (by the local elites) or directed abroad and used to further accumulation in the already advanced capitalist nations.

Baran's basic argument received considerable elaboration from ANDRE GUNDER FRANK, Samir Amin and other dependency school writers. The major insights of all these analyses centred around the recognition that capitalism is an international phenomenon in which the riches of the advanced nations and the poverty of the periphery are tied together: the rich are rich because the poor are poor, and vice versa. In Frank's terms, while the rich countries were developed, the poor countries were not undeveloped: they were underdeveloped.

The whole analysis had numerous political implications. Most generally (and probably most importantly), it provided a counter-argument to the position of bourgeois economists – namely, that the problem in the poor countries was an insufficient spread of capitalism and the solution to poverty in the

bargaining: advantageous factors

periphery was the more thorough penetration of capitalism.

As noted above, Baran (and Sweezy) critiqued capitalism in the advanced countries from the perspective of what has been termed MONOPOLY CAPITALISM – that is, countries whose markets were dominated by large corporations operating in oligopolistic markets. The Baran Sweezy approach never tried to show how existing capitalism conforms to predictions made by MARX in 1867 or LENIN in 1914. Rather, the object was to understand how contemporary capitalism works, based on its actual behaviour using tools provided by Marx, VEBLEN, KEYNES, Steindl, Kalecki and Hansen, among others.

Baran and Sweezy's core argument is that monopoly capitalism has a strong tendency towards economic stagnation. Unlike neo-classical theory, which argues that the system tends towards full employment if the market is left to its own devices (see NEO-CLASSICAL ECONOMICS), Baran and Sweezy's theory argues that the system tends toward crisis and depression.

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ROBERT LOONEY

bargaining: advantageous factors

The factors influencing advantages during bargaining can be discussed only in very general terms. Since bargaining takes place in many different contexts involving many different types of parties, different factors will influence the advantages/disadvantages in each situation. One point that clearly applies in every bargaining context, however, is that there is a close connection between the phrase 'bargaining power' and the factors influencing advantages in bargaining. Ultimately, it is

bargaining power that determines the outcomes in any negotiation setting. Since bargaining takes place between two (or more) parties with conflicting goals, power becomes the motivation for one party to compromise its goals in an effort to reach an agreement. Furthermore, assuming a simple bargain between A and B, A's bargaining power is equal to the willingness of B to reach agreement to terms proposed by A. In addition, B's willingness to agree to terms proposed by A involves a calculation by B of the costs of disagreement versus the costs of agreement on A's terms. Therefore A's bargaining power will be greater when A can make it more costly for B to disagree to A's terms and/or less costly to agree to A's terms.

Generally, it is possible to identify several different sources of power in the bargaining context: (1) information and expertise, (2) resource control, (3) legitimate (non-coercive) power, (4) location in the structure, and (5) personal power. These five categories are by no means independent. Rather, the factors contributing to each source of power overlap to a great extent:

- 1 *Information and expertise*: Information power refers to facts, data and so on that can be used to change another's stance on an issue. All things being equal, the more someone knows about a given situation, the more bargaining power they possess.
- 2 *Resource control*: Resource control exists when one party to a bargaining situation controls something the other party desires. The party controlling important resources can obtain concessions by using those resources in the bargaining situation.
- 3 *Legitimate (non-coercive) power*: One party will feel compelled to obey orders/directives from another because of the relative positions the two hold. The power to compel others to obey directives is referred to as legitimate (non-coercive) power and is derived from one's job, office or position in the organizational hierarchy. Often, this type of power is termed 'authority' and can be derived from reputation and/or prior performance.

- 4 *Location in the structure*: It is possible to possess power by virtue of one's position in an organizational situation. Even if not actually in a position of great authority, a person can be situated in position that provides great power.
- 5 *Personal power*: The personal characteristics that are brought to the bargaining situation can also be a source of power. Although many different traits can be sources of power, among the attributes discussed most often are personal persistence (tenacity), integrity, attractiveness (friendliness) and the ability to display emotion.

Given that conceptual definition of bargaining power, we can turn to examining the factors that influence it in one specific context: labour relations. In general, bargaining power in labour relations is influenced by several different forces: (1) the environment, (2) the structure of bargaining, (3) the organizational characteristics of all parties (typically the union and the employer), and (4) the negotiations process.

- 1 *Environmental factors*: Among the environmental factors that are influential are macro-economic conditions, micro-economic forces, public policies and the social/political context. For example, unions will have greater bargaining power if unemployment is low (thus creating a greater demand for labour) and inflation is high. In addition, the union will have greater power if the inelasticity of demand for labour is high – the inelasticity of the demand for labour being determined by the four Marshallian conditions (the inelasticity of demand for the final product, the substitutability of labour in the production process, the inelasticity of the other factors of production and the ratio of labour costs to the total costs of production). Finally, public policy greatly influences the outcomes in collective bargaining. This has been demonstrated by a number of empirical studies demonstrating a statistical relationship between laws/other public policy changes and bargaining outcomes.
- 2 *Structural factors*: Structural factors of

bargaining include both the formal structure and the informal bargaining that takes place along with the formal bargaining. The formal structure refers to the parties (employer and employees) that are legally bound by the collective bargaining agreement, while the informal structure refers to the parties who are impacted by a collective bargaining agreement. There are two important dimensions to the formal bargaining structure. The horizontal dimension refers to the range of employee or union interests involved, while the vertical dimension refers to the degree of centralization of employer interests.

- 3 *Characteristics of the parties*: Union sources of bargaining power include the percentage of the labour or product organized, the unanimity of preferences within the union (including the willingness of the members to strike if the union's demands are not met). The primary source of management's bargaining power is the willingness and ability to take a strike.
- 4 *Negotiations process*: The key characteristics in the process of negotiations that influence outcomes in bargaining are the strike/lock-out (or the right to strike and lock out employees) and the procedures used to resolve impasses in negotiations. As far back as 1932, John Hicks developed a model showing how the strike (both the union's right to strike and the employer's ability to endure a strike) is a crucial determinant of outcomes in bargaining (see Hicks, 1932).

A point worth noting is that there is a considerable inter-relationship between the four factors just discussed and their influence on outcomes in bargaining. Further, the environment is clearly the triggering force and the crucial factor determining outcomes in bargaining. Changes in the economic environment, laws and other public policies will have direct effects on bargain outcomes, but will also have indirect effects by enabling unions to organize a greater or lesser percentage of the market, making employers more or less able to withstand a strike, and so on.

bargaining: advantageous factors

Before leaving the discussion of bargaining power, it is worth noting that when the state (government) is involved as one of the parties, there are several things that differentiate the situation from a negotiation between two private entities. First, in the public sector, profit motive is not normally an objective. Thus the government's constraints and desired outcomes are likely to be different from a private entity's. Second, input, output and other market restraints that exist in the private sector are absent from the public sector. Third, the nature and purpose of the government (or a governmental entity) is to perform services for the citizenry; government's existence as government is special and unique in this manner, distinct from the private goals and desire for personal profit of the private sector market. Finally, perhaps the most important feature distinguishing negotiations with the state from purely private negotiations is the state's need to maintain a political democracy. The state bargains on behalf of, and is responsible for satisfying, a diverse constituency made up of individuals with vastly different interests. In fact, the entity negotiating with the state may well be a part of that constituency. Therefore, while the state's power may be high based on the five types of power discussed above (especially (2) resource control, (3) legitimate (non-coercive) power, and (4) location in the structure), the state is constrained by virtue of its need to satisfy a diverse constituency, made up of entities with potentially conflicting interests.

See also:

bargaining, concessionary; bargaining, state-firm; labour relations

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STEVEN E. ABRAHAM

bargaining, concessionary

In the labour relations context, 'concessionary bargaining' refers to the situation in which one of the parties receives less favourable provisions (for example, lower wages, reduced benefits) than it had in previous contexts. Although both unions and management can grant concessions, concessionary bargaining usually refers to unions granting concessions to management.

See also:

bargaining: advantageous factors

STEVEN E. ABRAHAM

bargaining, state-firm (SFB)

State-firm bargaining (SFB) is studied to assess the impact of FOREIGN DIRECT INVESTMENT (FDI). It gained significance when, in the 1970s, classical economics and DEPENDENCY THEORY appeared insufficient, because of their incapacity to explain the undeniable variation of FDI impact. Today, SFB is the dominant approach for studying the impact of FDI. However, in its present form, SFB is an indeterminate framework of analysis, not the source of generalizable hypotheses it was originally conceived to be.

The SFB approach rests on the idea that the impact of foreign investment is best understood as the outcome of a bargain between states and foreign investors. This 'bargain' (or, better, this sequence of bargains) is determined by (1) the resources over which each disposes, (2) the bargaining aims of each and (3) the constraints within which the bargaining occurs.

In early SFB models, the key resources of the foreign investors were their control over know-how and their access to markets and to capital; the key state resources were control over local markets and factors of production. The aims were control over the investment, indicated by equity ownership (see EQUITIES). These assumptions made possible the formula-

tion of testable hypotheses about the impact of FDI: the two central ones were that (1) bargaining outcomes are sectorally determined and (2) firm power is 'obsolescent'. First, since the relative importance of the power resources of states and firms varies by sector, bargaining outcomes should be expected to vary correspondingly. In sectors where technology, access to international markets and capital are of great importance, foreign investors should dominate – that is, retain maximum equity control (for example, in the computer industry); in those sectors where access to local resources is more important, the state should be stronger and local equity ownership predominate (an example being the textile industry). Second, state officials and local firms learn through their interaction with foreign investors. Moreover, investments become 'locked-in': if a foreign investor constructs an extractive facility, it cannot easily be withdrawn. Finally, when a product or process has existed for some time, it spreads and the foreign investor loses exclusive control. Thus, a foreign investor's bargaining power can be expected to become obsolescent and their equity control diminished in sectors where the initial investment is crucial and/or where innovation is relatively slow.

These two SFB-derived hypotheses have fared badly. One reason is that the arguments are easily turned around. For example, time may favour the foreign investor who establishes political allies and market control. Similarly, the state may dominate bargaining also in sectors where access to technology and international markets and capital is crucial, provided the competition is intense and/or the country is an important customer or location. More fundamentally, the assumptions of early SFB were highly problematic:

- 1 Bargaining power does not stem from a fixed set of resources. The relevance of any resource is related to the general setting (structural factors constraining states and firms) and the aims of state and firms.
- 2 'Control' fails to capture the array of possible firm strategies and government

basic needs

aims: a government's aims may range from increased employment to increasing competition in the national market.

- 3 Equity control is an inadequate focus. Control is exercised as effectively via indirect means (subcontracting, franchising and so on).

As a consequence of these widely accepted criticisms of the assumptions of early SFB, most current research is aimed at specifying the framework or parts of it. Moreover, although SFB remains the dominant approach for studying the impact of FDI, it is not a theory but a highly indeterminate framework of analysis. There is no consensus about how to study SFB, let alone about any theory deriving from it.

See also:

economic power; economic realism

ANNA LEANDER

BARTER TERMS OF TRADE see terms of trade

basic needs

The 'basic needs' approach to DEVELOPMENT became influential in the 1970s. Even though many countries were experiencing relatively high rates of economic growth, nevertheless large numbers of people remained in poverty, without access to the goods and services required to sustain an acceptable minimum standard of living. Economic growth might well be a necessary condition, but it was not sufficient on its own to achieve broader development objectives.

There were various policy responses to this perceived failure of 'development'. The WORLD BANK (Chenery *et al.*, 1974) championed strategies of 'redistribution with growth' and the International Labour Office (ILO, 1972; 1976) popularized the basic needs approach. As Stewart argues, a basic needs approach is

one 'which gives priority to meeting the basic needs of *all* the people' and it stems from the 'simple view that development should be concerned with removing absolute deprivation, as a first priority' (Stewart, 1985: 1). It is thus seen as a more direct approach to poverty alleviation than income redistribution *per se*.

Basic needs consist of both private goods (food, shelter, clothing) and certain PUBLIC GOODS (health services, education, water and sanitation). The dividing line between what is considered private and public in this context is not clear-cut, but to meet basic needs clearly requires a balance between the private and the public sectors. A basic needs approach might consist of the following:

- productive employment for the poor
- increased investment in traditional agriculture and the informal sector
- access to basic services for the entire population
- reduced differences between households and within households in their access to basic goods and services
- the creation of institutions that would enable the poor majority to participate more actively in the development effort (some writers use the term 'basic human needs' to make explicit the inclusion of non-material needs)

Although intuitively appealing, the basic needs approach to development raises a number of fundamental questions. What are 'basic needs'? Stewart (1985: chap. 1) distinguishes between two views. The first view asserts that there are certain goods and services which every human being needs in order to live a decent life. The second view defines basic needs objectives as being the improvement of conditions or quality of life (what she calls the 'full-life' interpretation). Stewart favours the latter interpretation, but argues that, in order to simplify it and make it operational, health and education must be the focus of any basic needs approach. In addition, we must be able to show that the consumption of basic needs

goods and services leads towards the achievement of our 'full-life' objective.

It is not clear, however, that this approach overcomes the fundamental problem of 'needs' versus 'wants'. What people need may not be what they want and vice versa. Clearly, basic needs are always relative with respect to time and place, and their definition cannot ignore income distribution and the notion of relative poverty. Moreover, providing for (and in some sense enforcing) the consumption of basic needs goods and services violates the assumption of consumer sovereignty and, at the global level, policies focusing on basic needs could be seen as undermining the national sovereignty of the recipient. In addition, the relationship between basic needs and economic growth is unclear. The basic needs approach may well increase consumption at the expense of investment and ultimately economic growth/structural change. On the other hand, as Singh (1979) has argued, there is no inevitable conflict between meeting basic needs and the transformation of productive structures via industrialization. Indeed, the reverse is the case – industrialization remains essential (although not, on its own, sufficient) to the meeting of basic needs.

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FREDERICK NIXSON

Basle Committee on Bank Supervision

The Basle Committee on Bank Supervision was established by the GROUP OF 10 (G-10) in 1974. It includes representatives from the G-10 countries, plus Luxembourg. The BANK FOR INTERNATIONAL SETTLEMENTS (BIS) provides the committee's secretariat and it is there that the committee meets three or four times a year. The committee's main accomplishments have been to clarify the division of responsibilities between home and host regulators, to establish a 1988 agreement on CAPITAL ADEQUACY STANDARDS for banks and to develop internationally agreed core-standards for bank supervision.

TONY PORTER

Basle Convention

The Basle Convention was an international regime, established in 1975 and amended in 1983, that committed the central banks of the wealthier industrial states to act as lenders of last resort for international banks experiencing solvency problems, when the headquarters of those banks were located in their country. This regime was replaced by the CAPITAL ADEQUACY STANDARDS agreed in 1988.

See also:

Basle Committee on Bank Supervision; lender of last resort

TIMOTHY J. SINCLAIR

Bauer, Peter (1915–)

Born in Budapest, Peter Bauer was one of the early pioneers in the field of development economics. A long-serving Professor of Economics at the London School of Economics, Bauer was made a life peer in 1983.

His early publications stem from fieldwork conducted in Malaya and West Africa. Based on this experience, Lord Bauer became convinced that the same economic principles that applied in Europe and North America applied equally in Africa and Asia. This view was in sharp contrast to that held by most other development economists in the early post-war period: they often assumed that a different set of economic principles applied in underdeveloped countries (see UNDERDEVELOPMENT).

Professor Bauer applied his approach to most of the major issues involving economic development, including the role of trading activity and the significance of the informal sector in developing; the role of cash crops in development; the relation between economic progress and occupational distribution; conceptual and practical problems of price and income stabilization, and the operation of COMMODITY AGREEMENTS. His contributions also offer an effective critique of received opinion on such issues as the vicious cycle of poverty, the widening gap of income differences within and between countries, the operation of foreign aid, and the theory and practice of development planning. He has also written on questions of methodology in economics, notably the tendency in modern economics to ignore the interaction of variables and parameters.

Bauer's outspoken views on AID best illustrate his conservative, market-oriented approach towards economic policy. While well intended, Bauer notes that these transfers of income from developed to developing countries enable THIRD WORLD governments to subvert market forces. Even worse, these funds are often diverted by corrupt ruling elites. Or (in his memorable phrase) 'aid is a phenomenon whereby poor people in rich countries are taxed

to support the life-styles of rich people in poor countries' (Bauer, 1976: 115).

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ROBERT LOONEY

beggar-thy-neighbour policy

Policies that attempt to increase a nation's output, income and employment at the expense of another nation's output, income and employment are called 'beggar-thy-neighbour' policies. There are a number of forms that such policies may take, including limiting imports through TARIFFS or QUOTAS, promoting exports through (for example) export SUBSIDIES or through reducing exchange rates (see EXCHANGE RATE) or CURRENCY DEPRECIATION. When successful, these policies have no impact on aggregate activity in the world as a whole, but rather shift employment from one country to another. The amount of additional unemployment in the second country will not necessarily match exactly the amount of additional employment in the first country, as in the case of different multiplier values or rates of labour-productivity between the countries. Beggar-thy-neighbour policies are not always successful, however: the second country may attempt to retaliate, for example. In this case, no shift in employment will occur, but everyone will end up less well off, as output and income in the world as a whole will decline. There are also a number of circumstances under which competitive depreciations may not work even without retaliation – for example, when non-price competition is significant or when MARSHALL–LERNER CONDITIONS are not satisfied.

Economists such as JOHN MAYNARD KEYNES, Joan Robinson and Abba Lerner railed against beggar-thy-neighbour policies, arguing that promoting domestic investment is the preferred means of increasing domestic em-

ployment. Under conditions of general under-employment, this will have the same general effect on the domestic economy as promoting an export surplus, but also results in a net gain for the world economy. Lerner, in particular, emphasized that the root cause of the problem is the lack of an effective commitment to true full employment. With a domestic policy of full employment, a nation has no need to play the beggar-thy-neighbour game.

MATHEW FORSTATER

behavioural economics

Behavioural economics is a heterodox movement in contemporary economics which studies human and organizational decision-making, emphasizing the limits of human RATIONALITY and the inadequacy of knowledge. The most important contribution of behavioural economics is a bundle of theories developed by various scholars on the process of decision-making, not as a rational process in pursuit of profit maximization, but the product of the contradictory goals and the conflicting values of various groups within any firm.

Behaviourism

Behaviourism is an influential and ambitious school of psychology that emerged at the beginning of this century, culminated mid-century and flourished mainly in the United States (through the work of J.B. Watson, E.C. Tolman, C.L. Hull, B.F. Skinner). Its roots can be found in associationist philosophy, functionalist psychology and Darwinian evolutionary theory. It began as a renunciation of mainstream psychology (that is, the introspective 'psychology of the mind' which emphasizes the study of the human consciousness), drawing attention primarily (almost exclusively) to patterns of behaviour in different settings. Behaviourism thus studies the influence of environmental stimuli on animal and human behaviour. In various laboratory (for animals) or social (for humans) settings, changes in

behaviour are examined objectively and without reference to the experience of consciousness. Behaviourism has exerted a modest but considerable influence on the social sciences, especially on anthropology, sociology, political science and, more recently, economics.

Behavioural economics

Economists and other social scientists who, under the influence of behaviourism, study economic phenomena, have presented a number of theories based on the actual objective observation of economic behaviour as it manifests itself in the real world and in a number of institutional settings. There human actors' decision-making processes were found to be less rational and generally different from the behaviour predicted by mainstream neo-classical economists' RATIONAL CHOICE theory (see NEO-CLASSICAL ECONOMICS).

Consequently, the decision-making process became the main object of research for behavioural economic theory, which identified three different problems in decision-making that are likely to cause a deviation from the rational choice model: (1) the asymmetries in information (information that is in any case imperfect), due to the scarcity and dispersion of knowledge (in the Hayekian sense); (2) the inherent limits to human rationality resulting from cognitive limitations, which preclude perfectly rational choice and permit only a satisfactory alternative – that is, bounded rationality – based on rules of thumb, experience and tradition; (3) the decisive influence of diverse institutional settings on human behaviour and especially on the formulation of preferences and expectations – preferences and expectations that are based more on social and psychological factors than on rational deliberation.

However, behavioural economists examine not only the behaviour of individual actors (for example, consumers) but also (and mainly) the behaviour of organizations, especially firms. Their basic concern is to explore the process of decision-making within organizations, the integration of the decision rules (namely, experience)

into the traditions of the firm (learning) and the process of change of these rules after feedback from the firm's outside environment.

The behavioural theory of the firm

The behavioural approach to the study of firms (developed initially by R.M. Cyert, J.G. Marsh and H.A. SIMON) is the most important contribution of behavioural economics to economic theory. The theory of the firm is one of the most important parts of modern micro-economics and enquires into the behaviour of firms, especially focusing on their decision-making processes (buying inputs, pricing outputs, choice of production processes, advertising, innovation, dividend policy, INVESTMENT decisions and so on) in relation to their goals.

According to the neo-classical theory, the single goal of a firm is the maximization of its profit (this is also the motive for the emergence of a firm in the first place, even in Coase's neo-institutional minimization-of-transaction-cost version). However, behavioural economists, by looking at the actual behaviour of groups within the firm, have observed that PROFIT MAXIMIZATION is not the single goal of the firm; there are other goals being pursued. In fact, the firm's behaviour is not even maximizing!

According to these 'managerial models of the firm', the behaviour of firms is not maximizing but 'satisficing' – that is, firms (and groups within the firm) do not strive to maximize a value (profit or something else), trying instead to reach a minimum but satisfactory level of a value (typically a minimum level of profit to secure the shareholders' support, but also acceptable solutions to everyday problems). Consequently, the main concern of the firm is to achieve a minimum level of profit in order to avoid conflicts with the shareholders and be free to pursue other goals. The other goals include the maximization of sales (total revenues), which are more impressive for shareholders and the public than the profits that are calculated at an unsuspected later time (according to Baumol, 1959);

the maximization of the rate of growth and the valuation ratio of the firm (Marris, 1964); the maximization of the managerial utility function (Williamson, 1964).

Thus the goals of the firm as a whole are determined by the variety of goals that the different groups, subgroups and individuals within the firm pursue for their own self-interest or according to their own beliefs and motivations. The interaction between these individuals and groups – with their differing power, influence and aspiration levels (and hence bargaining positions) – leads to an intricate decision-making process in pursuit of a set of complex and sometimes conflicting goals, rarely to the service of the shareholders. This agency problem occurs not only because of the well-known phenomenon of the separation of ownership from control, but also because of imperfections in the capital and product markets. According to the exponents of the theory, this kind of behaviour may not lead to the allocative EFFICIENCY that the one-dimensional firm beloved of neo-classical economists could achieve, but to a variation of organizational forms with internal efficiency and greater adaptability to diverse economic environments and institutional settings.

The impact of the behavioural theory on economists was significant, but it should not be exaggerated. The neo-classical approach to the theory of the firm remains the mainstream, especially after an eclectic incorporation of some concepts borrowed from behavioural analysis. The problem with behavioural economics is one they share with neo-institutional, AUSTRIAN SCHOOL and other quasi-heterodox economic theories: their problem is precisely the 'richness' and flexibility of their models, purporting to cover every single irregularity. Additionally, they treat these irregularities as the principal attributes of human personality and view them as decisive for human action, thus failing to generate any specific and useful predictions.

See also:

paradox(es) of rationality

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ARISTIDES N. HATZIS

Benelux

An acronym for the CUSTOMS UNION (CU) comprising Belgium, Luxembourg and the Netherlands, the Benelux was conceived during the period of Nazi occupation by the governments of the three countries while they were in exile in London. It was set up on 1 January 1948. The Benelux countries have constantly been at the forefront of the process of European integration. They were founding members of the EUROPEAN COAL AND STEEL COMMUNITY (ECSC) in 1951; played a leading role, through Belgian Foreign Minister Paul-Henry Spaak, in the formation of the EUROPEAN ECONOMIC COMMUNITY (EEC) in 1957, and even anticipated some policies (for example, the removal of border controls) that were only later adopted by the Community.

OSVALDO CROCI

benign neglect

'Benign neglect' was a term coined in the 1970s to describe a FOREIGN EXCHANGE policy that allows the EXCHANGE RATE to fluctuate freely: governments eschew intervention in the foreign exchange markets and have no target value for their exchange rate. It was applied to US exchange rate policy in 1977 and over the period 1980–5; the UK government pursued a similar policy in the early 1980s. Besides arguing that it is futile for governments to intervene – they 'cannot buck the markets', in Margaret Thatcher's words – proponents of

Bhopal

this policy argue that it is benign because it stimulates adjustment to eliminate BALANCE OF PAYMENTS imbalances. Thus it is benign for individual countries and the world economy. Countries pursuing an independent monetary policy (see MONETARY POLICIES) must accept market fluctuations in exchange rates, as the Mundell–Fleming theory shows (see MUNDELL–FLEMING MODEL).

The wide fluctuations in exchange rates from the 1970s mean that national authorities rarely pursue ‘benign neglect’ for long. In the mid-1980s, the US authorities changed their policy and began attempting to manage the dollar through the PLAZA and LOUVRE ACCORDS.

See also:

flexible exchange rates; floating exchange rates

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TAL SADEH

Bhopal

The Bhopal tragedy is often cited as evidence of the harm that ruthless profit-seeking MULTINATIONAL CORPORATIONS (MNCs) can inflict on people and the environment, especially in DEVELOPING COUNTRIES that are seeking to industrialize. The Indian city of Bhopal is where a disastrous ‘accident’ at the chemical factory of Union Carbide occurred in 1984: many thousands died and a much larger number had their health damaged. The US-based firm resisted paying compensation and, along with the Indian government (which held a large stake in the plant), was responsible for very long delays in the victims receiving their compensation. The Bhopal pesticide-manufacturing plant was not profitable, so Union Carbide cut corners on safety, allowing stan-

dards to fall far below those in its US plants. The Indian government, fearful that Union Carbide might close the plant, was lax in enforcing environmental standards, despite earlier incidents: hence its initial drive to put all the blame on Union Carbide.

See also:

dependency theory

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DAVID LAW

BILATERAL AID *see* aid, bilateral

bilateral development finance institutions

The provision of public funds in the form of debt finance by one country to another is made either through the multilateral institutions (such as the BRETTON WOODS SYSTEM) or by (larger) payments channelled through bilateral finance institutions. Bilateral institutions providing AID or debt finance are of three broad types: the quasi-commercial development finance institutions; the EXPORT CREDIT AND GUARANTEES departments; and the ministries for aid and DEVELOPMENT. The debt finance provided by bilateral development finance institutions is mostly viewed as concessional. Although some loans may be extended at market INTEREST RATES, the repayment structures and institutional context are judged by standards negotiated at the DEVELOPMENT ASSISTANCE COMMITTEE (DAC) of the ORGANISATION FOR ECONOMIC CO-OPERATION AND DEVELOPMENT (OECD) to accord them the concessionality classification. The volumes of both multilateral and bilateral development

finance have increased greatly in the post-war period.

Many European development finance institutions have their origin in the colonial era, although European states without colonies also developed such institutions in the post-war period. These institutions have become increasingly intermeshed due to the co-financing and reciprocal UNDERWRITING of development projects, often also with the involvement of their multilateral equivalents. A rapid growth of bilateral development finance institutions (and of their co-financing of projects) occurred following the early 1980s DEBT CRISIS. This is partly due to the effect of the debt crisis on perceived country risk, where institutional security became the preferred option of investors when export credit insurance seemed no longer to be enough. This growth was also due to the provision of debt finance provided for by the broader framework of STRUCTURAL ADJUSTMENT PROGRAMMES (SAPs) to achieve external payments balance.

From a PUBLIC GOODS perspective, bilateral development finance institutions provide a public good by extending concessional CREDIT to areas where private INVESTMENT capital would otherwise be unavailable, due to perceived exorbitant country risk. Their activities thus correct MARKET FAILURES to provide finance by ameliorating excess demand. From the perspective of the 'new INSTITUTIONALISM', institutions in general and bilateral development finance institutions in particular can be seen as facilitating more efficient economic exchange. They can monitor political and investment risks closer to the site of the proposed investment; provision internally against default and spread the cost of this insurance across the portfolio; can borrow investment capital cheaply since they themselves are underwritten by the richer states in the global economy. These attributes help the institutions to augment capital flows to poorer countries. From a Marxian perspective, flows of bilateral funds affect the scope, reach and volume of global money flows. Money here has a role in regulating the pace of output of production. These institutions could be viewed

as extending the rule of money; of facilitating the INTERNATIONALIZATION of capital, and of furthering the concentration and centralization of FINANCE CAPITAL above and regulatory to the circuits of merchant and industrial capital in which SURPLUS VALUE is concretized.

See also:

aid, bilateral; aid, multilateral; capital, law of the concentration of; financial institutions; International Finance Corporation (IFC); value theory

SARAH BRACKING

bilateral dual-taxation treaties

Any international trade transaction or foreign investment gives rise to the question of which municipal authority ought properly to collect taxes on the profits of that commercial activity. Taxation on the profits of FOREIGN DIRECT INVESTMENT (FDI) presents the most difficulties, as there is the potential for the home and host state to employ a different formula to determine the 'home' state of the investor: for instance, one state may utilize the control test (where the company is managed and controlled), while the other may rely on the place of incorporation. If these are different, both states could claim tax on the whole of the profits from a single investment. This would constitute double taxation and would penalize the investor.

Thus comprehensive 'bilateral dual-taxation treaties' (also known as 'double-taxation treaties') are mechanisms through which states guarantee that an investor's profits will be taxed only once. This is mainly accomplished in one of two ways. The first is the exemption method, whereby an investor does not pay tax in the country of residence if tax is paid in a foreign state. The second is a reciprocal arrangement between states, whereby each state refunds to the foreign parent company the tax paid by its subsidiaries located on each state's territory.

bilateral investment treaties (BITs)

A secondary function of dual-taxation treaties is to prevent tax evasion. Although most treaties are based on the standard ORGANISATION FOR ECONOMIC CO-OPERATION AND DEVELOPMENT (OECD) model dual-taxation agreements, there remains the potential for tax avoidance.

See also:

tax havens

JARROD WIENER

bilateral investment treaties (BITs)

'Bilateral investment treaties' (BITs), also known as 'investment promotion and protection agreements' (IPPAs), are treaties concluded between two states to establish principles of conduct governing FOREIGN DIRECT INVESTMENT (FDI). Such treaties offer legal protection to private investors who are not subjects of international law by providing them with recourse to remedies for a breach of an agreement at the international level. For the failure to honour a BIT, which is legally binding on the parties, involves an international delict, since a breach of a treaty is a breach of international law. Investors could therefore seek the assistance of their home state to enforce the treaty on the international plane on their behalf.

A common provision of BITs is that disputes between a host state and a foreign investor shall be settled through compulsory international arbitration, rather than governed by national laws which can be changed arbitrarily. Another is that investors shall be indemnified in cases of nationalization. Although it is a settled norm in international law that expropriation must be accompanied by compensation, there has been controversy historically between developed capital-exporting states and developing states over the terms of compensation. Developed states have long argued in favour of the Hull formula, under the terms of

which compensation should be 'prompt, adequate and effective', where 'prompt' means without delay, 'adequate' means of fair market-value before the act of expropriation became known and 'effective' relates to payment in a freely convertible currency. The developing countries had maintained that compensation must be based on their ability to pay, taking into account the profits already made by the investor.

There is at present a network of over 600 BITs involving 133 states. A survey of 335 BITs in 1991 found that they all contained the 'prompt' and 'effective' elements of the Hull formula, while 195 adopted the Hull formula in its entirety. All but one of the 335 surveyed provided for international arbitration. The existence of such a large network of BITs raises the issue of whether these not only reflect a new, welcoming attitude of developing states towards foreign investment, but whether the large number of treaties with similar provisions comprise a diffuse international regime which endorses a particular norm to govern international investment.

JARROD WIENER

billiard ball model

Until the late 1950s, the so-called 'billiard ball model' dominated the study of INTERNATIONAL RELATIONS (IR). Such a model, firmly embedded in the realist paradigm (see REALISM), was based on two assumptions: (1) states were unitary actors and (2) they acted according to the precepts of means end rationality. This meant that states chose goals much like human beings do, and that they were always able to identify and employ the best available means to reach their goals. It also meant that the world of international politics was perceived in terms of actions-reactions. States, in other words, were seen as acting primarily in reaction to previous actions of other states, much like a billiard ball moves on a felt-covered slate after having been hit by another ball and hits a new one in turn.

This model came under criticism for two different reasons. From a normative point of view, it was argued that the billiard ball model, in looking at states as independent, self-contained units, privileged the conflictual aspect of international politics over the co-operative one. These critics advanced the so-called 'cobweb model', that viewed states as consisting of many different social groups having a wide variety of interests shared by other groups in other states.

From a more scientific point of view, the billiard ball model was criticized because it looked at the process of foreign policy decision-making as a 'black box', the inner workings of which (although assumed to be rational) remained beyond detailed analysis. These critics advanced the so-called 'decision-making approach'. This first identified key inputs or determinants of foreign policy (individual, role, governmental, societal or systemic), then argued that the relative potency of these variables explained outcomes (decisions or actions) depending on the attributes of states (size, nature of the economy and of the polity) under examination, as well as on the ISSUE AREAS involved (status, political, economic). Focusing on the 'black box' – the process whereby governments as complex organizations took their decisions – the decision-making approach also argued that RATIONALITY did not always prevail. Hence, the development of the 'bounded rationality model' of decision-making, which maintained that the rationality of actors could be impaired by either cognitive–psychological or bureaucratic–cybernetic factors.

In the 1990s, however, the billiard ball model returned, if not in name, at least through the assumptions contained in the so-called 'RATIONAL CHOICE approach' that now dominates much of the academic work in IR.

OSVALDO CROCI

bimetallism

'Bimetallism' describes a monetary standard which, in theory, is founded on two commod-

ities: silver and gold. Bimetallism features full legal tender and virtually free coinage for both metals, and full interconvertibility between gold, silver and notes according to the bimetallic mint ratio (which sets the official price, based on fixed weights of the metals). In practice, one metal has always dominated the other in circulation due to GRESHAM'S LAW (the metal overvalued at the mint crowds out the undervalued metal). While commodity standards prevailed among industrialized nations before World War I, they have been replaced by fiat (paper) standards later in the twentieth century.

See also:

bullionism; commodities; convertibility, currency; gold exchange standard; gold standard

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GIULIO M. GALLAROTTI

black economy

The 'black economy' may refer to transactions between individuals that are hidden from the tax authorities. This description of the black economy as synonymous with tax evasion excludes other illegal or criminal activities, including prostitution, the drugs trade and so on. However, the literature also contains other definitions of the black economy that do include criminal and illegal activities other than tax evasion.

Tax evasion should be distinguished from tax avoidance. Tax evasion means hiding income from the tax authorities and is as such an illegal activity, even though the activities that generate the (black) income may be perfectly legal. Tax avoidance, however, is the perfectly legal use of tax loopholes in order to minimize the tax burden.

Black Monday

The size of the black economy is probably larger in many DEVELOPING COUNTRIES and in countries in transition from a centrally planned economy (see COMMAND ECONOMIES) to a market economy than it is in developed countries. Governments in the former countries may find greater difficulty in monitoring transactions than governments in the latter.

One alternative interpretation of the black economy is as a set of black markets. A black market is a market in which government regulations are violated. A specific form results from price controls (for example, on energy or rental housing). Usually, these controls specify a price ceiling, which is the highest price that sellers are allowed to charge legally. When the price ceiling is set above the equilibrium price, it is not effective, since the equilibrium can still be attained. When the price ceiling is set below the equilibrium price, however, the equilibrium price is not attainable anymore. Therefore, such a price ceiling is said to be effective. An effective price ceiling causes excess demand. At the maximum price, the quantity demanded exceeds the quantity supplied. Both the quantity exchanged and the price ceiling are lower than their equilibrium values. If the price mechanism is not permitted to allocate the available supply among potential buyers, other allocation methods must be used. This may be a legal method, such as queuing (supplies are sold on a first-come, first-served basis), a licensing system and so on. It may also be an illegal method, however, such as a black market where the good is sold for prices above the maximum price fixed by the government. An effective price ceiling creates the potential for a black market, because purchasing the good at the controlled price and selling it at the black-market price can make a profit.

M. PETER VAN DER HOEK

Black Monday

'Black Monday' took place on 19 October 1987, when the Dow Jones industrial average in the United States plunged by 508 points to

1,738.74 (amounting to 22.6 per cent of its value) in just one day. This amounted to the largest one-day point and percentage loss in US stock-market history, causing investors to collectively lose around US\$1 trillion. It also sparked fears of a second GREAT DEPRESSION and the possibility of worldwide financial collapse. Even companies with a traditionally strong market share, such as INTERNATIONAL BUSINESS MACHINES (IBM) and Eastman Kodak, did not emerge unscathed: both suffered heavy losses. The US Federal Reserve (see FEDERAL RESERVE SYSTEM) quickly intervened in order to support the financial system by providing sufficient funds to banks to allow them to provide credit to securities firms. Nevertheless, it was not until January 1989, fifteen months after Black Monday, that the Dow Jones returned to its pre-crash levels.

In the wake of Black Monday, several steps were taken to avoid the possibility of such an occurrence happening again in the future. Thus, in 1988, so-called 'circuit breakers' were introduced into the New York Stock Exchange. These are trading rules that are designed to slow falling prices in the event of any potential future collapse, the most common of which is the 'uptick/downtick rule' that comes into operation whenever the Dow Jones moves 50 points up or down from where the market opened. If this happens when the market is going down, arbitrageurs can sell certain stocks only when the price of that stock is rising, and vice-versa. Once triggered, the rule applies for the rest of the trading day, unless the Dow Jones moves to within 25 points of its initial trading level.

See also:

arbitrage

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ALISON M.S. WATSON

Black Wednesday

'Black Wednesday', the 16 September 1992, was a date of political humiliation for the UK government at the hands of the very City of London foreign exchange markets that it had previously deregulated. Prior to Black Wednesday, the central element of the UK government's counter-inflationary strategy had been the country's membership of the EXCHANGE RATE MECHANISM (ERM) of the EUROPEAN MONETARY SYSTEM (EMS). Both Prime Minister John Major and Norman Lamont, the Chancellor of the Exchequer, had recently reaffirmed their unequivocal commitment to sterling's ERM membership.

On the Tuesday evening prior to Black Wednesday, reports emerged that the President of the Bundesbank had stated that the previous weekend's realignment of the ERM would have been more effective had it been more extensive. The implication was that sterling should have been devalued. When the London markets opened for trading on Wednesday morning, the British government found itself powerless to prevent a dramatic devaluation of its currency, despite the announcement of unprecedented increases in base rates from 10 per cent to 12 per cent, and then 15 per cent, within the space of less than four hours. Currency speculators, most notably George Soros' Quantum Fund, correctly gambled that the Major government would be forced to abandon its defence of the pound at a central parity within the ERM of DM2.95.

Devaluation may have provided UK exporters with a short-term stimulus to recovery from the longest post-war domestic recession, but Black Wednesday also fatally undermined the Conservative Party's reputation for more competent economic management than their rival political parties, and accentuated the electoral unpopularity of the Major government – a trend from which it never recovered.

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SIMON LEE

Bolshevik

The term 'Bolshevik' denotes the practice and parties of revolutionary Marxism that were guided by the ideas of LENIN (see MARXISM–LENINISM).

Bolshevik was originally the name (meaning 'majority') of Lenin's faction in the Russian Social Democratic and Labour Party (RSDLP), which opposed the MENSHEVIKS at the party's divided Second Congress in 1903. The Bolsheviks demanded a tight party whose members worked actively for the party programme under its discipline. The Mensheviks wanted a looser definition of membership.

Behind this lay differences about the tasks and prospects for the coming Russian revolution. Both agreed that the tasks were the destruction of autocracy and the establishment of a 'bourgeois' parliament. But Bolsheviks argued the overweening autocracy had created a supine bourgeoisie incapable of leading the peasants in democratic revolt, so the workers had to do so for them. Mensheviks argued that the bourgeoisie must lead. The Bolsheviks therefore sought to maximize the scope and independence of working-class revolt, while the Mensheviks sought tactics permitting alliances with the liberals.

The Bolsheviks formed an independent party in 1912, before two further events catapulted them from junior partner to general staff of international Marxism. In 1914, the mass parties of the Second International were irreconcilably split when the bulk of their leaderships capitulated to the war effort of their own rulers. Then, in October 1917, the Bolsheviks led a victorious insurrection in Russia and withdrew Russia from the war, winning them leadership of the revolutionary wing of international SOCIALISM.

Bonapartism

Bolshevism became the kernel of a new worldwide (Third) Communist International and was further developed as a distinctive theory and practice of revolutionary Marxism. This broke radically with the dominant tradition of Second International Marxism, which fatalistically had expected economic development to translate into growing working-class organization and maturation of mass socialist consciousness. Bolsheviks retrospectively saw in this the seeds of 'opportunism', in which mass bureaucratized parties with passive memberships sacrificed their politics in order to sustain their organization, make electoral gains and so on; therefore they also saw in it the source of the betrayal of internationalism in 1914.

From its inception, Bolshevism provoked bitter dispute. Supporters claim it rejected historical fatalism in favour of the revolutionary activity of the masses. It combined the distinctness and independence of socialist organization (in order to combat dilution of socialist principles and 'opportunist' adaptation to present circumstances at the cost of long-term revolutionary aims) with active immersion in direct CLASS STRUGGLE (unlike the old mass social democratic parties) – an immersion which entailed battling for ideas, often against the current, and (where possible) taking a practical lead in direct struggle.

Critics have variously claimed Bolshevism was Machiavellian, authoritarian and elitist; that the October insurrection was premature – a voluntarist coup – and that this was proved by the rise and final collapse of STALINISM. Its contemporary defenders claim Bolshevism's inheritance continued through revolutionary Marxists like Leon Trotsky, and that the politics and bureaucratic forms of the Stalinist state and parties bear no relation to original Bolshevism.

See also:

Trotskyism

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ANDREW WRIGHT

Bonapartism

The notion of 'Bonapartism' was developed by KARL MARX and Friedrich Engels. It is defined as a dictatorial form of the capitalist state, in which state power is achieved by the authoritarian leadership of an individual ruling over a society through their control of all state apparatus and by maintaining and guaranteeing order so as to make possible rapid economic development. In writings about the state, this form has also been characterized as the relative autonomy of the state from society (Draper. 1977). By centralizing state power, the authoritarian leader tries to break the political power of the emerging bourgeoisie, who are not able to articulate their political and economic interests autonomously, while at the same time protecting the bourgeoisie's material power by enforcing the rule of liberal economy. France under the rule of Louis Bonaparte after the Revolution of 1848 can be considered as the original form of the Bonapartist state, defined by Marx in his writing 'The Eighteenth Brumaire of Louis Bonaparte' (see Marx, 1968).

According to ROBERT W(ARBURTON) COX (1987), the Bonapartist state cannot be extracted from its international background. The historical preconditions for the emergence of a Bonapartist state are a permissive economy and a permissive world order.

See also:

authoritarian states

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MEHDI PARVIZI AMINEH

bonds

A bond is a debt instrument in which the issuer (debtor) promises to repay the investor the amount borrowed (known as the principal or par value) at some stated future time, plus interest over that period. A typical bond would specify both the fixed date at which the amount borrowed is due and the contractual amount of interest that is to be paid at regular intervals. Bonds with a maturity date of between one and five years are generally considered to be short-term bonds, while bonds with a maturity date of between five and ten years are viewed as intermediate term. Long-term bonds are those with a maturity of greater than ten years.

One of the most significant characteristics of a bond is who issues it. Issuers include both central and municipal governments, international organizations (such as the WORLD BANK), and financial and non-financial corporations. The number of issuers has increased during the last couple of decades, as borrowing and lending activities in the international financial markets have shifted from traditional

syndicated bank loans to other types of security – such as bonds.

Bonds are usually a form of long-term security. However, they may be irredeemable and either secured or unsecured. In addition, the term 'bond' can be given to types of non-fixed security, such as 'property bonds' (which provide the holder with a yield on funds invested in property) or 'managed bonds' (in which the funds are placed in a variety of investments). On the other hand, bonds that are never repurchased by the original issuer, who therefore pays interest forever, are known as perpetuities (or 'Consols', after a famous bond issue called 'Consolidated Stock').

Although bonds have been around for centuries – the best evidence suggesting that bond issue first occurred in Venice in the late twelfth century – their popularity as a means of government finance only really began during the eighteenth and nineteenth centuries, when states issued bonds in order to finance their (often military) endeavours. Bonds serve an important economic function as a means of bringing savers and investors together. Given the number of bond issuers and the amount of bond debt outstanding, they are one of the most important of the instruments that boost investment.

See also:

globalization; interest rates

ALISON M.S. WATSON

boomerang effect of foreign direct investment (FDI)

The profits of FOREIGN DIRECT INVESTMENT (FDI) have a tendency to 'boomerang' back to the site of origin. This is often achieved through TRANSFER PRICING. There are numerous examples of transnational corporations (TNCs) (see MULTINATIONAL CORPORATIONS (MNCs)) underdeclaring profits in less-developed countries. The 'boomerang effect'

borrowing

is a term associated with the writings of Susan George.

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LYN JAGGARD

borrowing

Borrowing is one side of an intertemporal exchange of resources. The borrower receives a sum of money in the present time-period and promises to repay the money, usually with interest, on specified future dates. In resource terms, the borrower gains command over current resources in exchange for a promise to provide the lender resources in future periods. Borrowing from foreign lenders produces credit items in the capital account of a nation's BALANCE OF PAYMENTS: a monetary inflow (credit) is exchanged for the promised future repayment, which is an asset. A nation that is a net borrower thus tends to have a capital account surplus.

MICHAEL VESETH

Boulding, Kenneth (1910–93)

Kenneth Boulding was a prolific and insightful thinker whose contributions cut well across the conventional boundaries of economics. His research and scholarly interests extended to general systems theory, futures studies, and peace and conflict studies. Along with innovative thinkers like Quincy Wright and JOHAN GALTUNG, he is an important pioneering figure in the field of modern peace research.

Born in Liverpool and educated at Oxford University in philosophy, politics and econom-

ics, he held a number of academic posts, including professorships in economics at the University of Michigan and the University of Colorado. Among various activities and initiatives, Boulding played a major role in establishing the International Peace Research Association (1965). He was, for a time, president of the American Association for the Advancement of Science. In later years, much of his most creative work was done in collaboration with his wife, Elise Boulding, a noted sociologist and peace researcher.

Like J.K. GALBRAITH and GUNNAR MYRDAL, Boulding did not fit neatly within the boundaries of either conservative or radical economic thinking. He was quick to point out pathologies both in excessive state intervention and in the myth of PERFECT COMPETITION in the marketplace. Many economists, he warned, were caught up in the anxious pursuit of an 'exact science' status for their discipline and risked losing a moral or ethical dimension to their work. In a classic essay, 'Is economics necessary?', he argued that while the natural and physical sciences may have gained the world, they had lost their soul. A prime challenge for economics was to keep 'its own soul' in a world where scientific research is too often 'prostituted to special interests' (Boulding, 1970).

It is arguably less Boulding's particular economic theorizing and more his call for a rethinking of 'economics' within a cross-disciplinary and ethical framework that gives his work its contemporary significance. In addition to raising crucial questions about social responsibility in economics, his work foreshadows later green and feminist critiques, such as those by Hazel Henderson in her 1996 book, *Building a Win Win World: Life beyond Economic Warfare*. In a paper presented in 1966 entitled 'The economics of the coming spaceship Earth', Boulding criticized the poverty of peace- and ecology-related imagination in orthodox economic thinking. 'Cowboy economy' assumptions of 'illimitable plains' for reckless exploitation and expansion were likely to become, he stated, less tenable in an

increasingly interdependent and environmentally fragile world (Boulding, 1970).

See also:

ecological economics; Richardson processes; sustainable development; war; welfare capitalism

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FRANCIS P. HUTCHINSON

boundaries

Boundaries separate otherwise distinct entities. Occupying a point on a boundary itself might represent the possession of unique properties, as in the case of much of micro-economic thought, which seeks to represent the world in terms of mathematical functions. In the modern international political economy, boundaries are much less distinct than they once were.

Much of Western political thought is predicated on the idea of boundaries or borders dividing specific, discrete political and geographic units. This results from and contributes to the effort to circumscribe people and societies within particular units for purposes of enumeration and of taxation. This has been particularly true of feudal societies. In other words, ruling elites sought to locate people, families and towns within definite boundaries so as to enforce rule over them and extract resources from them which might be used in defensive and offensive military activities. Church parishes, electoral constituencies and national borders all reinforce this idea that people are within a particular location and belong in some way to it. During the COLD WAR, this spatial definition was manifested in armed forces confronting one another along defined borders, such as (for example) the borders of the Soviet controlled bloc and still the South North Korean border.

However, various factors and methods of thinking have combined to reduce the relevance of this concept of boundaries. From science, it has become apparent that the universe is not composed of atoms and molecules so much as a variety of particles that are stranger and less definable than had been thought. From linguistics, the separation of the signifier and the signified (that is, the name of a thing and the thing itself) contributes the idea that objective observation is not generally possible and that the way we see the world is conditioned by our memories, beliefs and desires. From politics, the collapse of the Soviet system has removed the simple supposed dichotomy between socialism/capitalism, good/bad, on which so much policy was based. In other words, what had appeared to be a modernist world, in which it was possible to delineate and to understand the laws of the universe, has given way to a post-structuralist if not post-modernist world (see POST-MODERNISM; POST-STRUCTURALISM), in which it is increasingly difficult to determine what is and what is not real and absolute.

What does this mean for the concept of boundaries? First, it is evident that the type of economics or politics that assumes individuals

Brady Plan

and organizations to be wholly within or on a boundary needs to be rethought. Second, it is possible to create or recreate borders which are more meaningful or at least more potent. Borders around the EUROPEAN UNION (EU) or NORTH AMERICAN FREE TRADE AGREEMENT (NAFTA), for example, accurately define areas of particular economic activity. On the other hand, the divisions placed on people in the former Yugoslavia are revealed as being untenable without a strongly imposed structure from above. One of the goals of the international political economist is to understand where boundaries are useful and where they should be dismantled in the light of tolerance and inclusiveness.

See also:

internationalization

JOHN WALSH

Brady Plan

The Brady Plan of 1989 was a further attempt to resolve the international DEBT CRISIS, following the BAKER PLAN in 1985. The plan, named after US Treasury Secretary Nicholas Brady, recognized that the debts owed to the major international banks were unlikely to be repaid in full and marked a move towards reducing, as well as rescheduling, those debts. As with the Baker initiative, Brady focused on middle-income debtors.

The plan involved the INTERNATIONAL MONETARY FUND (IMF) and the WORLD BANK, which would commit additional resources to be lent in support of market-based methods of debt and debt-service reduction. The lending was to remain conditional on debtors' agreement to carry out structural adjustment, but there was a recognition in US circles that the austerity measures of the mid-1980s were encountering considerable local hardship and opposition.

The Brady Plan built on the secondary markets for debt which were already operating

in the mid-1980s. Under Brady, the international agencies concluded new agreements with major debtors: first Mexico, the Philippines and Costa Rica, and later Venezuela, Morocco and Uruguay. These agreements involved a variety of debt-reduction instruments, including DEBT-EQUITY SWAPS and debt buybacks at a discount.

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JOHN THOBURN

brain drain

The 'brain drain' is associated with the international migration of labour, which has increased rapidly in the past forty years. In order to trace the effects and policy implications of labour migration, it is useful to divide it into skilled and unskilled labour.

The effects of skilled labour migration are widely thought to be more damaging to the exporting countries. One reason is that skilled workers more generally take their families with them. As a result, they are less likely to remit incomes back to the exporting countries and they are also less likely to return to their 'home' countries, in which case there is said to be a brain drain. The brain drain is often argued to be especially costly to LESS-DEVELOPED COUNTRIES (LDCs) because they not only lose one of their scarcest resources, but they also lose people whose training invariably has been subsidized.

There are three solutions that have been proposed to deal with the brain drain. The first is to reduce the salary differential by paying skilled workers more in their home countries. One problem with this is that non-salary incentives (such as research facilities and other working conditions) often play an important role in the migration decision. The second

possibility is for governments to stop subsidizing the training. The problem with this is that the knock-on benefits of EXTERNALITIES arising from the training are lost. The third possible solution is one that was examined in depth by Bhagwati and Partington (1976), namely for income or other taxes to be imposed by the importing countries on the skilled migrating labour and for the proceeds to be remitted to the exporting countries as a form of compensation.

See also:

factor mobility; labour mobility

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CHRIS EDWARDS

Brandt Report

In 1980, an unofficial group of policy-makers under the chairmanship of Willy Brandt, known as the Brandt Commission, produced a report which attempted to restate the problems inherent in the relationship between rich and poor countries and, in addition, to provide some practical remedies. The Brandt Report attempted to persuade those who read it that the North-South conflict between rich and poor was as dangerous to the international community as was the bipolar relationship between East and West during the COLD WAR.

The Brandt Report was practical in its language, arguing that, rather than North and South having divergent interests, the common interests that they shared were actually much greater than they realized. The Brandt Report was unusual, then, in that it proposed a community of interests that was pertinent for all sovereign states. At the core of this was the notion that rich countries should transfer a massive amount of resources to poor countries,

increasing official AID to the South by up to 1 per cent. This would help poor countries to gain the resources to be able to industrialize by buying materials from the North. That aiding the poor would help the rich seemed obvious, but it did seem to presuppose the notion of a world government, of which there was no suggestion. The Brandt Report, then, appeared to be asking highly separate states to cooperate without the institutions to facilitate this. Although the Brandt Commission followed up their initial report with a new memorandum on the 'common crisis' in an attempt to 'avert an economic collapse', neither report did much more than instigate debate – although the latter was, of itself, very useful in the discussions of DEVELOPMENT that occurred during the 1980s.

See also:

dependency theory; New International Economic Order (NIEO)

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ALISON M.S. WATSON

Braudel, Fernand (1902–85)

Fernand Braudel was a French historian whose life's work was an attempt to synthesize history with the social sciences. A leader of the Annales School of history (named after the journal founded in 1929), he first came to prominence in 1949 with the publication of *The Mediterranean and the Mediterranean World in the Age of Philip II* (Braudel, 1973). Originally written while Braudel was a prisoner of war, *The Mediterranean* illustrated brilliantly the *histoire totale* promoted by the Annales (Hexter, 1972; Kinser, 1981). He was editor of *Annales* from 1951 to 1969, in which time his approach to history replaced traditional French political, largely diplomatic, history as

the national academic establishment. The school was further institutionalized by the founding of the Maison des Sciences de l'Homme in 1962, which Braudel headed until his death. He became widely recognized as a leading world historian with the publication of his three-volume *Civilization and Capitalism: Fifteenth to Eighteenth Century* (see Braudel, 1981, 1982, 1984 for the English editions).

Braudel's work incorporates two frameworks of analysis that are still challenging and relevant today. First, he uses a multiple concept of time. He is famous for his application to history of the *longue durée*: the slow, imperceptible movement of history sometimes referred to as 'structural time' or 'structural history'. Although this time was invented to counter the *courte durée* of traditional history with its focus on events, sometimes referred to as 'eventism', it would be wrong to equate this Braudel invention with his *histoire totale*. Braudel (1980) argued that history should combine different conceptions of time and not focus solely on any one perspective. Starting with *The Mediterranean*, Braudel's work used three social times, with a *moyenne durée* that captured cyclical patterns in history complementing the study of events and structures. He remained highly sceptical of 'eternal laws' of social science, dismissing *la très longue durée* as a timeframe accessible only to 'the sages' (by which he did not mean economists). Second, Braudel uses a three-layered model of human activity, which he likens to the storeys of a house. The bottom level consists of material life, by which he means the everyday routine reproduction of a society. The middle level is the economic sphere, by which he means the competitive market activities operating on a local and regional level. The top level consists of the activities of political and economic creators of monopolies in the world economy. The three volumes of *Civilization and Capitalism* are organized on this basis, as their titles indicate: *The Structures of Everyday Life*, *The Wheels of Commerce* and *The Perspective on the World*.

The three-layer model is intellectually revolutionary in its implications, because Braudel locates capitalism in the top layer and thus separates it from the market (Wallerstein,

1991). According to Braudel, it is the middle layer which is the transparent realm for social activity (and thus the main focus for social science), with both the bottom and top layers remaining opaque (for different reasons) and thus relatively neglected by the academy. For Braudel, capitalism is defined by where the major accumulations of capital occur, and this is in the monopoly sphere and not in competitive markets. With their multivarious use of state protection and technological innovation, capitalists thrive as flexible, adaptable world-economy opportunists, making large profits by being anti-market, non-specialist enterprises. From the original charter companies to today's global corporations, the watchword has been to control processes and not let them be determined by the market. Hence Braudel's common challenge to both liberal and Marxist social-science traditions: capitalism operates against the market.

IMMANUEL WALLERSTEIN (1978, 1991) has been the major promoter of Braudel's work in contemporary social science. He interprets the *Annales* school as one of three distinctive intellectual traditions – the other two are German *Staatswissenschaften* and Marxism, which resisted first British and then American hegemonic domination of how we should understand our social world and its changes. Against both their universalizing social science and idiographic historical studies, Braudel pioneered a geohistorical perspective which is more important than ever today, when both the end of history and the end of geography are being widely proclaimed on behalf of the political and economic forces that dominate our times.

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PETER J. TAYLOR

Bretton Woods system

The Bretton Woods system is commonly understood to refer to the international monetary regime that prevailed from the end of World War II until the early 1970s. Taking its name from the site of the 1944 conference that created the INTERNATIONAL MONETARY FUND (IMF) and WORLD BANK, the Bretton Woods system was history's first example of a fully negotiated monetary order intended to govern currency relations between sovereign states. In principle, the regime was designed to combine binding legal obligations with multilateral decision-making, conducted through an international organization (the IMF) endowed with limited supranational authority. In practice, the initial scheme (as well as its subsequent development and ultimate demise) were directly dependent on the preferences and policies of its most powerful member, the United States.

Design of the Bretton Woods system

The conference that gave birth to the system, held in the US resort village of Bretton Woods in New Hampshire, was the culmination of

some two-and-a-half years of planning for post-war monetary reconstruction by the treasuries of the United Kingdom and the United States. Although attended by all forty-four allied nations, plus one neutral government (Argentina), conference discussion was dominated by two rival plans developed, respectively, by Harry Dexter White of the US Treasury and by JOHN MAYNARD KEYNES of the United Kingdom. The compromise that ultimately emerged was much closer to White's plan than to that of Keynes, reflecting the overwhelming POWER of the United States as World War II drew to a close.

Although, at the time, gaps between the White and Keynes plans seemed enormous – especially with respect to the issue of future access to international liquidity – in retrospect it is their similarities rather than their differences that appear most striking. In fact, there was much common ground between all the participating governments at Bretton Woods. All agreed that the monetary chaos of the inter-war period had yielded several valuable lessons. All were determined to avoid repeating what they perceived to be the errors of the past. Their consensus of judgement was reflected directly in the Articles of Agreement of the IMF.

Four points in particular stand out. First, negotiators generally agreed that, as far as they were concerned, the inter-war period had conclusively demonstrated the fundamental disadvantages of unrestrained flexibility of exchange rates (see EXCHANGE RATE). The floating rates of the 1930s were seen as having discouraged trade and investment, and to have encouraged destabilizing speculation and competitive depreciations. Yet, in an era of more activist economic policy, governments were at the same time reluctant to return to permanently fixed rates on the model of the classical GOLD STANDARD of the nineteenth century. Policy-makers understandably wished to retain the right to revise currency values on occasion as circumstances warranted. Hence a compromise was sought between the polar alternatives of either freely floating or irrevocably fixed rates – some arrangement that might gain the advantages of both without suffering the

Bretton Woods system

disadvantages of either. What emerged was the 'pegged rate' or 'adjustable peg' currency regime, also known as the 'par value' system. Members were obligated to declare a par value (a 'peg') for their national money and to intervene in currency markets to limit exchange-rate fluctuations within maximum margins (a 'band') of 1 per cent above or below parity; but they also retained the right, whenever necessary and in accordance with agreed procedures, to alter their par value to correct a 'fundamental disequilibrium' in their BALANCE OF PAYMENTS. Regrettably, the notion of fundamental disequilibrium, though key to the operation of the par value system, was never spelled out in any detail – a notorious omission that would come back to haunt the regime in later years.

Second, all governments generally agreed that if exchange rates were not to float freely, states would also require assurance of an adequate supply of monetary reserves. Negotiators did not think it necessary to alter in any fundamental way the GOLD EXCHANGE STANDARD that had been inherited from the inter-war years. International liquidity would still consist primarily of national stocks of gold or currencies convertible, directly or indirectly, into gold ('gold exchange'). The United States, in particular, was loath to alter either the central role of the dollar or the value of its gold reserves, which at the time amounted to three-quarters of all central-bank gold in the world. Negotiators did concur, however, on the desirability of some supplementary source of liquidity for deficit countries. The big question was whether that source should, as proposed by Keynes, be akin to a world central bank able to create new reserves at will (which Keynes thought might be called *bancor*), or a more limited borrowing mechanism, as preferred by White. What emerged largely reflected US preferences: a system of subscriptions and quotas embedded in the IMF, which itself was to be no more than a fixed pool of national currencies and gold subscribed by each country. Members were assigned quotas, roughly reflecting each state's relative economic importance, and were obligated to pay into the IMF a

subscription of equal amount. The subscription was to be paid 25 per cent in gold or currency convertible into gold (effectively the US dollar, which was the only currency then still directly gold convertible for central banks) and 75 per cent in the member's own money. Each member was then entitled, when short of reserves, to borrow needed foreign currency in amounts determined by the size of its quota.

A third point on which all governments agreed was that it was necessary to avoid a recurrence of the kind of economic warfare that had characterized the decade of the 1930s. Some binding framework of rules was needed to ensure that states would remove existing EXCHANGE CONTROLS limiting currency convertibility (see CONVERTIBILITY, CURRENCY) and return to a system of free multilateral payments. Hence, members were in principle forbidden to engage in discriminatory currency practices or exchange regulation, with only two practical exceptions. First, convertibility obligations were extended to current international transactions only. Governments were to refrain from regulating purchases and sales of currency for trade in goods or services. But they were not obligated to refrain from regulation of capital-account transactions. Indeed, they were formally encouraged to make use of capital controls to maintain external balance in the face of potentially destabilizing 'hot money' flows (see CAPITAL, CONTROLS ON). Second, convertibility obligations could be deferred, if a member so chose, during a post-war 'transitional period'. Members deferring their convertibility obligations were known as Article XIV countries; members accepting them, had so-called Article VIII status. One of the responsibilities assigned to the IMF was to oversee this legal code governing currency convertibility.

Finally, negotiators agreed that there was a need for an institutional forum for international cooperation on monetary matters. Currency troubles in the inter-war years, it was felt, had been greatly exacerbated by the absence of any established procedure or machinery for intergovernmental consultation. In the post-war era, the IMF itself would provide such a

forum – in fact, an achievement of truly historic proportions. Never before had international monetary cooperation been attempted on a permanent institutional basis. Even more pathbreaking was the decision to allocate voting rights among governments not on a one-state, one-vote basis, but rather in proportion to quotas. With one-third of all IMF quotas at the outset, the United States assured itself an effective veto over future decision-making.

Together, these four points defined the Bretton Woods system – a monetary regime joining an essentially unchanged gold exchange standard, supplemented only by a centralized pool of gold and national currencies, with an entirely new exchange rate system of adjustable pegs. At the centre of the regime was to be the IMF, which was expected to perform three important functions: regulatory (administering the rules governing currency values and convertibility), financial (supplying supplementary liquidity) and consultative (providing a forum for cooperation among governments). Structurally, the regime combined a respect for the traditional principle of national SOVEREIGNTY – especially, of course, that of the United States – with a new commitment to collective responsibility for management of monetary relations, expressed both in mutually agreed rules and in the powers of the IMF.

The implicit bargain

Negotiators at Bretton Woods betrayed a remarkable optimism regarding prospects for monetary stability after the war's end. Underlying their choice of exchange rate system, for example, seemed a clear expectation that beyond the post-war transitional period (itself expected to be brief) payments imbalances would not be excessive or require sacrifice of domestic stability for the sake of external equilibrium. The pegged-rate regime was manifestly biased against frequent changes of currency values, since states had to demonstrate the existence of a fundamental disequilibrium before they could alter their par values; yet governments were left with few other

instruments, other than capital controls, to deal with payments disturbances. Negotiators evidently felt that major future threats to stability were more likely to come from private speculation than from basic price or income developments. They also presumably believed that the IMF's centralized pool of liquidity, though limited, would suffice to cope with any financing problems that might emerge.

As matters turned out, their optimism proved utterly Panglossian. Monetary relations after the war were anything but stable, the transitional period anything but brief, the IMF's initial resources anything but sufficient to cope with emerging payments difficulties. Hence, after a short burst of activity during its first two years, IMF lending shrank to an extremely small volume for over a decade. Instead, the burden was shifted to the one actor at the time with the financial and economic resources needed to shoulder responsibility for global monetary stabilization – namely, the United States.

Fortunately, for reasons of its own, the United States was not only able but willing to take on that responsibility, in effect assuming the role of global monetary hegemon: money manager of the world. US hegemony was exercised principally in three ways. First, a relatively open market was maintained for imports of foreign goods. Second, a generous flow of long-term loans and grants was initiated, first through the MARSHALL PLAN and other related aid programmes, then through the reopened New York capital market. Third, a liberal lending policy was eventually established for provision of shorter term funds in times of crisis. Since the reserves of most countries were near exhaustion and the IMF's pool of liquidity was manifestly inadequate, the rest of the world was more than willing to accumulate dollars. Given the scarcity of central bank gold outside the United States and limited prospects for new gold production, the United States became the residual source of global liquidity growth through the deficits in its own balance of payments. Other governments with payments surpluses stabilized their exchange rates by

Bretton Woods system

buying dollars. The United States pledged convertibility of its dollars into gold at a fixed price, thus making the greenback a near perfect substitute for gold.

Though multilateral in formal design, therefore, the Bretton Woods system in practice quickly became synonymous with a hegemonic monetary regime centred on the dollar, much in the same manner as the classical gold standard of the nineteenth century had come to be centred on Britain's pound sterling. For gold exchange standard, many said, read dollar exchange standard.

Like the British in the nineteenth century, the United States did not actively seek global monetary leadership. Indeed, during the inter-war period the responsibilities of hegemony had been deliberately evaded. On the other hand, unlike the British, once the Americans found themselves in the role, they soon came to welcome it for reasons that were a mixture of altruism and self-interest. Being money manager of the world fitted in well with the United States' new-found leadership role in the COLD WAR against the Soviet Union. US policy-makers perceived a need to promote the economic recovery of important allies in Europe and Japan, as well as to maintain a sizable and potent military establishment overseas. All this cost money. The privilege of financing deficits with its own currency ('liability financing') meant that the United States was effectively freed from external payments constraints so as to spend as freely as its leaders thought necessary to promote objectives believed to be in the national interest. The United States could issue the world's principal reserve currency in amounts presumed to be consistent with its own priorities – not necessarily those of foreign dollar holders.

Foreign dollar holders, for their part, conceded this policy autonomy to the United States because it also directly contributed to their own economic rehabilitation. The United States accepted the necessity, for example, of preferential trade and payments arrangements in Europe, despite their inherent discrimination against US exports; likewise, the United States accepted the necessity of granting Japanese

exporters access to the US market at a time when most other countries remained closed to goods labelled 'Made in Japan'. In effect, an implicit bargain was struck. Allies of the United States acquiesced in a hegemonic system that accorded special privileges to the US to act abroad unilaterally to promote their own or collective interests. The United States, in turn, condoned its allies' use of the system to promote their own prosperity, even if this happened to come largely at the short-term expense of the United States. The subsequent evolution of the Bretton Woods system may be read as the history of that implicit bargain. The system's eventual breakdown in the early 1970s may be read as the bargain's final collapse.

From dollar shortage to dollar glut

The chronology of the Bretton Woods system can be divided into two periods: the period of dollar shortage, lasting roughly until 1958, and the period of dollar glut, covering the remaining decade and a half (see DOLLAR, US).

The period of the dollar shortage was the heyday of US monetary hegemony. The term 'dollar shortage', universally used at the time, was simply a shorthand expression for the fact that only the United States was then capable of assuring some degree of global monetary stability; only the United States could help other governments avoid a mutually destructive scramble for gold by promoting an outflow of dollars instead. Dollar deficits began in 1950, following a round of devaluations of European currencies (at the insistence of the United States) in 1949. In following years, shortfalls in the US balance of payments (as conventionally measured) averaged roughly US\$1.5 billion a year. But for these deficits, other governments would have been compelled by their reserve shortages to resort to competitive devaluations or domestic deflation to keep their payments in equilibrium; they would certainly not have been able to make as much progress as they did toward dismantling wartime exchange controls and trade barriers. Persistent dollar deficits thus actually served to avoid a destabilizing policy conflict. The period up to 1958

was rightly called one of 'beneficial disequilibrium'.

After 1958, however, the persistent deficits of the United States began to take on a different coloration. Following a brief surplus in 1957, owing to special circumstances, the US balance of payments plunged to a US\$3.5 billion gap in 1958 and to even larger deficits in 1959 and 1960. This was the turning point. Instead of talking about a dollar shortage, observers began to speak of a dollar glut. In 1958, Europe's currencies returned to convertibility. Subsequently, the former eagerness of European governments to obtain dollar reserves was transformed into what seemed to be an equally fervent desire to avoid excess dollar accumulations. Before 1958, less than 10 per cent of US deficits had been financed by calls on the US gold stock (the rest being financed with dollars). During the next decade, almost two-thirds of the US cumulative deficit was transferred in the form of gold, mostly to Europe. Bretton Woods was clearly coming under strain.

The Triffin dilemma

One source of strain, inherent in the structure of the post-war gold exchange standard, was first illuminated by economist Robert Triffin in his influential 1960 book, *Gold and the Dollar Crisis*. A gold exchange standard, Triffin argued, is fundamentally flawed by its reliance on the pledge of convertibility of some national currency, such as the dollar, into gold (Triffin, 1988). The Bretton Woods system had come to rely on US deficits to avert a world liquidity shortage. But already by the time Triffin wrote, America's dollar overhang was growing larger than its gold stock. The resulting erosion of the net reserve position of the United States was bound in time to undermine confidence in the dollar's continued convertibility. In effect, therefore, states found themselves caught on the horns of a dilemma – what came to be known as the TRIFFIN DILEMMA. To forestall speculation against the dollar, US deficits would have to cease. But this would confront the system with a liquidity problem. To

forestall the liquidity problem, US deficits would have to continue. But this would confront the system with a confidence problem. Governments could not have their cake and eat it too.

Not that governments were unwilling to try. By the mid-1960s, negotiations were begun to establish a substitute source of liquidity growth in order to reduce systemic reliance on dollar deficits, culminating in agreement to create SPECIAL DRAWING RIGHTS (SDRs), an entirely new type of international reserve asset. Governments hoped that with SDRs in place, any future threat of world liquidity shortage could be successfully averted. On the other hand, they were totally unprepared for the opposite threat – a reserve surfeit – which is in fact what eventually emerged in the late 1960s. Earlier in the decade, a variety of defensive measures were initiated in an effort to contain mounting speculative pressures against the dollar. These included a network of reciprocal short-term credit facilities (SWAPS) among central banks, as well as enlarged lending authority for the IMF. But in the end none proved sufficient to avert a decisive loss of confidence in the dollar.

Exchange-rate rigidity

A second source of strain was inherent in the structure of the par value system: the ambiguity of the key notion of fundamental disequilibrium. How could governments be expected to change their exchange rates if they could not even tell when a fundamental disequilibrium existed? And if they were inhibited from repegging rates, how then would international payments equilibrium be maintained? In practice, governments began to go to enormous lengths to avoid the 'defeat' of an altered par value. The resulting rigidity of exchange rates not only aggravated fears of a potential world liquidity shortage. It also created irresistible incentives for speculative currency shifts, greatly adding to the global confidence problem as well.

The heaviest weight on exchange rates at the time was of course the dollar glut – more accurately, the persistent payments imbalance

Bretton Woods system

between the United States and the surplus countries of Europe and Japan. Each side blamed the other for the disequilibrium. America felt its erstwhile allies could do more to reduce their surpluses by inflating or revaluing their currencies; the Europeans and Japanese, conversely, contended that it was the responsibility of the United States, with the world's biggest deficit, to take the first steps to correct the situation. Both sides felt discriminated against. The surplus countries argued that the United States' privilege of liability financing deficits created an asymmetry in the regime favourable to the United States. None of them, after all, enjoyed such a degree of policy autonomy. The United States, on the other hand, believed that use of the dollar by other governments as their principal intervention medium to support par values created an asymmetry more favourable to Europe and Japan, since it left the United States itself with no effective control over its own exchange rate. The United States controlled only the price of its currency in terms of gold. It had no direct means to influence the rates at which other countries bought or sold dollars.

The bargain comes unstuck

In fact, the debate over asymmetries masked a deeper political conflict. The post-war bargain was coming unstuck. In the United States, concern was growing about the competitive commercial threat from Europe and Japan. The cost of subordinating domestic interests to help strengthen foreign allies was becoming ever more intolerable. Conversely, concern was growing in Europe and Japan about the United States' use of its privilege of liability financing – the 'exorbitant privilege', as France's Charles de Gaulle called it. The Europeans and Japanese had just one major weapon they could use to curb America's policy autonomy: their right to demand conversion of accumulated dollar balances into gold. But as the dollar overhang continued to grow, making the Triffin dilemma ever more acute, it was a weapon most governments became increasingly reluctant to deploy.

At bottom, the Bretton Woods system rested on one simple assumption – that economic policy in the United States would be stabilizing. The absence of an effective external discipline on US policy could not threaten the regime so long as that assumption held, as it generally did prior to 1965. During the first half of the 1960s, the US foreign deficit actually shrank as a result of a variety of corrective measures adopted at home. After 1965, however, US behaviour became increasingly destabilizing, mostly as a result of increased government spending on social programmes at home and an escalating war in Vietnam. The US economy began to overheat and inflation began to gain momentum, causing deficits to widen once again. Yet Washington pointedly declined to undertake any new ameliorative actions under a calculated policy of *BENIGN NEGLECT*. With governments elsewhere committed to defending their pegged rates by buying the growing surfeit of dollars, a huge reserve base was created for global monetary expansion. Inflation everywhere began to accelerate, exposing all the latent problems of Bretton Woods. The pegged-rate system was incapable of coping with widening payments imbalances and the confidence problem was worsening as speculators were encouraged to bet on devaluation of the dollar or revaluations of the currencies of Europe or Japan.

Ultimately it was the United States, still the leading member of the system, that brought the drama to its denouement. Concerned about the United States' rapidly deteriorating payments situation, as well as rising protectionist sentiment in the US Congress, President Richard Nixon was determined to force the Europeans and Japanese to accept a mutual adjustment of exchange rates. The US might lack effective control over the dollar exchange rate under the prevailing rules of the game, but it did still have the power, alone among governments, to unilaterally change the rules themselves should US policy-makers see fit. Accordingly, on 15 August 1971, the convertibility of the dollar into gold was suspended, freeing the greenback to find its own level in currency markets. Eighteen months later, in February 1973, after

new waves of speculation against a realigned structure of par values negotiated in late 1971 (the so-called 'Smithsonian Agreement'), the monies of all the industrial countries were set free to float independently. With these decisions, both the par value system and the gold exchange standard (the two central elements of the post-war monetary regime) were effectively terminated. The Bretton Woods system passed into history.

Significance for international political economy

For students of international political economy (IPE), the significance of the Bretton Woods system lies primarily in the inspiration it gave to the later development of REGIME THEORY. International regimes, which act as a sort of governance mechanism between sovereign states, are conventionally defined as sets of implicit or explicit principles, norms, rules and decision-making procedures around which actors' expectations converge in a given issue area. The Bretton Woods system was an especially well articulated regime, formally negotiated and concretely embodied in a multilateral organization, the IMF. The circumstances of the system's birth and life cycle offered scholars invaluable material for assessing the relative importance of diverse variables in promoting or inhibiting economic cooperation among governments.

Most obviously, Bretton Woods provided evidence of the key role of power in shaping the design and evolution of international regimes, giving rise to HEGEMONIC STABILITY THEORY. The dominance of the United States in the negotiations at the wartime conference seemed to confirm the vital importance of hegemonic leadership in the initial formation of international regimes; even more critically, the US assumption of responsibility for stabilization after the war appeared to affirm the subsequent and continuing need for hegemony in order to preserve economic order. Conversely, the malign effect of less disciplined use of power could be seen in the destabilizing impact of the United States' benign neglect of its balance of

payments toward the end of the Bretton Woods era.

Less obviously, Bretton Woods also provided evidence of the lasting effectiveness of regimes themselves, even after shifts in the distribution of inter-state power that had been associated with their origins or early operation. Though the managerial role of the United States in the post-war period was eventually undermined by the emergence of economic and political rivals, leading ultimately to the spectacular breakdown of both the gold exchange standard and the par value system in the early 1970s, monetary relations did not collapse in chaos as they had in similar circumstances during the 1930s. Rather a significant degree of cooperation was preserved under the auspices of the IMF, which continued to perform its assigned regulatory, financial and consultative functions; the regime's underlying principles and norms continued to exercise influence over the behaviour of national governments. That demonstration of the possibility of durability in a social order at the international level, seemingly at variance with the predictions of hegemonic stability theory, may well be the most significant of all the Bretton Woods system's implications for IPE theory.

See also:

hegemonic stability

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broker-dealers

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BENJAMIN J. COHEN

BRITISH EMPIRE *see* Empire, British

broker-dealers

The term 'broker-dealer' refers to the 'sell side' of the market for securities. A broker-dealer firm acts both as a principal, investing for their own account, and as a dealer, reselling securities from its inventory through stock exchange trading systems to institutional investors (or the 'buy side' of the market).

The broker-dealer's order flow is composed of an order book which consists of both executable limit orders (an order to buy or sell a security at a specific price) and market orders (an order to buy or sell a security at the best price available). The dealer makes a commitment to buy or sell securities at the bid and ask prices. The bid-ask spread reflects the prices at which investors can immediately purchase securities. The ask price is the price that a customer must pay for the immediate execution of the trade, whereas the bid price is what the price investors must pay for the initiation of an immediate sale.

Generally dealers are confronted with two types of traders: liquidity-motivated traders

and informed traders. Dealers tend to make profits from liquidity trading since these traders (who are unable to trade large orders in a cost-effective manner in order-driven auction markets) pay a higher price to obtain immediacy. On the other hand, informed traders (who possess superior information) are able to reduce the bid-ask spread in order to transact at a better than expected price in the market. In response, dealers have powerful incentives to conceal their information about recent transactions in order to avoid the immediate release of information about recent trades by arranging trade with counterparties. The use of protected trades is intended to deny the party executing the trade the best execution price.

In order to avoid the potential conflict of interest between broker-dealer and trader, in the United States the SECURITIES AND EXCHANGE COMMISSION (SEC) now requires broker-dealers to obtain the best execution for their trades. Of course, the best execution duty does not imply that brokers achieve the best price. There are a number of variables (for example, the availability of trading technology) which reveal the difficulties in enforcing such a vague standard for broker-dealers. Proponents of broker-dealers argue that courts should, when determining whether the best practice rule has been violated, focus on whether standard industry practices were followed when the dealer executed the price terms of the contract. Even if there are no apparent violations of market rules, the question regarding the aims of the best execution rule remains open. Should the best execution rule require that gains from trading improvements apply to all orders or does it merely reflect a general view of best execution in the market? When answering this question, financial economists have argued that it is unreasonable to assume that every trade must be restricted to particular execution principles. Factors such as market structure, market timing, the size of an order and the commission charged are important factors when making reasonable enquiries about the duty of best execution.

JOSEPH McCAHERY

bubbles

A 'bubble' can be defined as a rapid rise and subsequent collapse in the price of an asset, when this price is driven by the market's expectation of the price's future level rather than the asset's fundamental value. Much financial theory has been based on the assumption that financial markets are characterized by inherently rational and efficient processing of information. From this perspective, bubbles are a puzzle; indeed, it is only recently that sustained attempts to develop formal models of bubbles have been made.

A useful alternative approach which is historical and qualitative is found in *Manias, Panics and Crashes* (1989) by CHARLES KINDLEBERGER. Drawing on the financial theories of Hyman Minsky, Kindleberger analyses forty bubbles between 1720 and 1987, and identifies certain common patterns. The boom is sparked by an unusual exogenous event such as war. It is fuelled by an expansion of instruments of private credit, such as bills of exchange. Fraud is often associated with the boom, as swindlers take advantage of the less seasoned and overly enthusiastic investors which it attracts. At a certain point, scepticism about the continued viability of the boom emerges, perhaps stimulated by news of insiders selling or by evidence of fraud. The boom becomes a crash as the price of the original asset declines precipitously. Credit extended to investors begins to contract and the stability of banks may be threatened as good loans turn into bad ones.

Bubbles have long had an international dimension. For instance, in 1719 the South Sea and Mississippi Bubbles, centred in England and France respectively, were both based on unfounded expectations regarding new overseas companies. Moreover, investors from one of the centres of speculation bought and sold shares in the other. The international effects of bubbles can spread from the original object of speculation to have consequences for other sectors, for exchange rates and for the health of the financial system in other countries. Contemporary examples can be found in

budget deficits

the impact of the Mexican peso crisis of 1994–5 on other emerging markets, in the initially positive and subsequently negative effect of the late 1980s Japanese ‘bubble economy’ (involving stock and real estate prices) on the foreign operations of Japanese banks, contributing to the East Asian financial crisis of 1997–9. States often step in to calm panics by carrying out LENDER OF LAST RESORT functions, although this is complicated at the international level by the lack of centralized authority. Stabilizing initiatives rely, therefore, on individual powerful states or on responses coordinated through institutions such as the INTERNATIONAL MONETARY FUND (IMF) or the BANK FOR INTERNATIONAL SETTLEMENTS (BIS). Currently states are also seeking, through institutions such as the BASLE COMMITTEE ON BANK SUPERVISION, to prevent the emergence of financial crisis by improving prudential supervision.

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TONY PORTER

budget deficits

Budget deficits occur when governments spend more on public programmes than they earn from tax receipts in any given year, irrespective of any accumulated assets the government may have. When the same result is experienced by

corporations, the company makes a loss; an individual is said to be ‘in debt’, even if they have positive net worth because of assets. Surpluses – the much rarer situation – occur when income exceeds current expenditure.

Government budget deficits have been characteristic of most developed nations since the 1960s. Deficits were advocated as a way of increasing demand, attaining and maintaining full employment, and keeping alive the post-war settlement between labour and employers. Until the 1980s, budget deficits were policy orthodoxy. Then a dramatic shift occurred in sentiment, as monetarist and neo-liberal ideas (see MONETARISM; NEO-LIBERALISM) about the proper role of the state captured the attention of policy-makers concerned with fighting INFLATION and low productivity growth. Acceptance of budget deficits has been replaced in Western policy circles with a new consensus that deficits represent the crowding out of efficient private investment.

See also:

national debt; sovereign debt

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TIMOTHY J. SINCLAIR

buffer stocks

‘Buffer stocks’ are stockpiles of a storable commodity managed with the intent of controlling the price. If the price of the commodity is low, the buffer stock buys and holds the commodity to tighten supplies and raise the price; if the price of the commodity is high,

stocks are released from the buffer to increase supplies and lower the price. Buffer stocks have been used in COMMODITY AGREEMENTS for tin, cocoa and natural rubber in attempts to dampen wide fluctuations in world market prices, and a combined buffer stock for ten core commodities was the centrepiece of the proposed INTEGRATED PROGRAMME FOR COMMODITIES (IPC). Townsend (1977) showed that a buffer stock used to fix the price of a commodity would always go bankrupt eventually, a result borne out by the catastrophic failure of the tin buffer stock in 1985.

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JOHN M. TALBOT

Bukharin, Nikolai Ivanovich (1888-1938)

One of the foremost theoreticians and political leaders of the BOLSHEVIK Party and the Communist International in the 1920s and early 1930s, Nikolai Ivanovich Bukharin contributed significantly to the theory of MARXIAN ECONOMICS.

Bukharin came into contact with the Russian Social-Democratic Party in 1906. In 1909, he was arrested for his political activity and in 1910 escaped abroad. By 1913, Bukharin was resident in Vienna, where he attended lectures by Professor Böhm-Bawerk and studied the theories of the Austrian (marginalist) School of Economics. *The Economic Theory of the Leisure Class* (first published in Moscow in 1919) was partly based on the studies of this period. In this book, Bukharin argued that the theory of marginal utility confuses *value* with *use-value*, and criticized the foundations of NEO-CLASSICAL ECONOMICS, focusing on what he regarded as the three major shortcomings of the AUSTRIAN SCHOOL: subjectivism, an ahis-

torical approach to social and economic relations, and the consideration of consumption and demand as the driving forces of the economy.

It was during this period of exile, in 1915, that Bukharin also wrote his *Imperialism and the World Economy* (see Bukharin, 1987). The main idea of this book – written echoing Hobson's *Imperialism* (1902), Hilferding's *Finance Capital* (1909) and Luxemburg's *The Accumulation of Capital* (1912) (see HOBSON, J(OHN) A(TKINSON); HILFERDING, RUDOLF; LUXEMBURG, ROSA) – was that, in the era of imperialism, capitalism constitutes a unified global social and economic structure. This conception of 'world capitalism' was, however, abandoned by Bukharin ten years later.

In 1917, after the February Revolution, Bukharin returned to Russia. He was elected a member of the Central Committee of the Bolshevik Party and soon became the leader of the Moscow Bolshevik organization, playing a leading role in the seizure of the city in October 1917. In the same year, Bukharin became the editor of *Pravda* and a member of the party's Politbureau. In 1919, his 'Theory of the Dictatorship of the Proletariat' was published, a pamphlet which had been written several years earlier and is believed to have influenced Lenin's famous *The State and Revolution* (1917). During the civil war, Bukharin (who belonged to the 'Left Communists') was an enthusiastic supporter of 'war-communism'. *The Economics of the Transition Period*, written in 1920, reflected his belief that a direct transition to communism was possible after abolishing money and the market.

With *The ABC of Communism* (written jointly with Evgeny Preobrazhensky in 1919) and *Historical Materialism: A System of Sociology* (written in 1920), Bukharin tried to popularize Marxist theory. Both contributions were among the most widely read books by communists in the 1920s. However, they portray the simplistic and dogmatic version of Marxism that prevailed in the Soviet Union from the early 1930s. In his *Prison Notebooks* (1996:419-72), GRAMSCI thoroughly questioned

the scientific and dialectical character of Bukharin's *Historical Materialism*.

In 1925, Bukharin's *Imperialism and the Accumulation of Capital* was published in Germany (see Bukharin, 1972). This work, which is mainly a rejoinder to Luxemburg's *Accumulation of Capital*, includes one of the most profound Marxist critiques of the theory of UNDERCONSUMPTION. Bukharin took his stand on three propositions. First, that the world economy cannot be comprehended as an undifferentiated whole. Second, that capital INTERNATIONALIZATION does not emerge from a supposed 'excess of capital' or a 'lack of investment opportunities' in capital-exporting countries, but from competition between individual capitals in their search for extra profits on the world market. Third, that there is no inherent and permanently active cause of capitalist crisis which could lead to the collapse of capitalism; instead, 'a unity of contradictions' exists, which may (depending on the tension of these contradictions) put a limit on the process of capitalist 'expanded reproduction'. However, Bukharin remained faithful to Hilferding's schematic conception of 'monopoly predominance' over the capitalist economy, which infringes some fundamental Marxian theses on capitalist competition and the average rate of profit.

After the death of Lenin in 1924, Bukharin approached the right wing of the party, becoming the theoretician of the troika Zinoviev–Kamenev–Stalin in their struggle against the Left Opposition of Leon Trotsky. Soon afterwards, in 1926, he supported Stalin against the United Opposition of Trotsky, Zinoviev and Kamenev. In the same year, he was appointed Chairman of the Communist International.

In this period, Bukharin proposed an economic policy favouring the independent peasants (kulaks and petty-producers). He adhered to the idea of a long-term continuation of the NEW ECONOMIC POLICY (NEP) of 1921, as a strategy of gradual transition to socialism. He thus supported all measures that would help the peasants become more prosperous, so that their demand for consumer goods would

increase. This would encourage the growth of light industry and establish the bases for the development of a state-owned heavy industry. In 1923–4, the ruling bodies of the Bolshevik Party accepted Bukharin's positions (and rejected Preobrazhensky's theses for a 'primitive socialist accumulation'). However, the peasants, instead of selling their products to the market in order to purchase industrial goods, preferred to hold their surplus in an effort to force Soviet industry to lower its prices. In 1928 a grain crisis broke out, forcing the government to take coercive measures in order to avert famine in the cities. Stalin broke off the alliance with Bukharin, who was defamed as 'right deviationist' and was stripped of all his power. In 1937 he was expelled from the party and one year later he was put on trial (in one of the infamous Moscow Trials) on charges of treason and was executed. He was politically rehabilitated by the Gorbachev leadership in 1988.

See also:

Marxism–Leninism; socialism in one country; Trotskyism

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GEORGE E. ECONOMAKIS
JOHN MILIOS

bullionism

'Bullionism' is a sixteenth-century doctrine based on exchange of bullion. Bullion consists of coins, ingots or bars made out of precious metals, such as gold and silver. Bullion was considered the most valuable form of MONEY that could be possessed, because of its complete liquidity in trade. In the sixteenth century, a shortage of bullion in the form of coins raised its value and led to hoarding. During this time, coins were filed and clipped for their precious-metal content. Full-weight coins were driven out of circulation, leading Sir Thomas Gresham to observe: 'bad money drives out good' (see GRESHAM'S LAW).

Bullionism is related to the monetary policy of MERCANTILISM (see MONETARY POLICIES). Bullionism viewed the economic prosperity of a country in terms of the amount of bullion that it possessed. This encouraged a country to regulate transactions in FOREIGN EXCHANGE and bullion to maintain a TRADE SURPLUS.

See also:

bimetallism

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J. ANDREW GRANT

Bundesbank

The Deutsche Bundesbank is the central bank of the Federal Republic of Germany. The Bundesbank performs a number of functions: it is the bank of issue, the banker's bank, the state's bank, the guardian of monetary reserves and so on. Moreover, the Bundesbank regulates the amount of money in circulation with the aim of safeguarding the currency. This means keeping its value stable by achieving price stability.

Within the EUROPEAN UNION (EU), the Bundesbank plays a key role in monetary policy, since it is regarded as the most important and reliable monetary institution within the EU, especially given Germany's post-war history of price stability (see MONETARY POLICIES).

N.M. DUYKERS

bureaucracy

'Bureaucracy' (from *bureaucratie*, a term coined in France by the physiocrats in the middle of the eighteenth century) is supposed to be the model type of organization, which aspires to be efficient, impartial and rational, an instrument of democracy fully compatible with the rule of law. However, it assumed the meaning of an omnipotent, inefficient and irrational body of RENT-SEEKING administrative officials (and administrative procedures) whose only purpose is to torture citizens who have been caught in its toils.

Bureaucracy is not a new phenomenon, only to be associated with modern complex societies. Different formations of bureaucracy, as a separate class between the ruling class and the common people, are a recurring phenomenon in all developed societies, the Mandarins in the Chinese Empire being the most characteristic example.

Weber's theory of bureaucracy

MAX WEBER is the major theorist of

bureaucracy. His work has not only framed the debate since the beginning of the century, but it has influenced all discussions of large organizations ever since, by laying the foundations of organization theory. Observing the gradual bureaucratization of social, economic and political institutions (for example, church, firms, military) in Western Europe, Weber approached the trend initially as a sign of the rationalization and progress of SOCIETY.

For Weber, bureaucracy could be the IDEAL TYPE of a 'rational-legal' form of domination (*Herrschaft*: that is, in Weber's conceptual system, the legitimate exercise of power), an organization exercising legitimate authority. In this sense, bureaucracy is absolutely necessary for the rationalization of administration and government in a free-market economy that needs the support of a large administrative state. Expertise, combined with the idea of the rule of law, could lead to the elimination of 'affective' and 'traditional' elements (as, for example, in the patrimonialism of the Mandarins) in decision-making and its replacement by RATIONALITY and principles.

Thus, in Weber's system, bureaucracy should be an administrative body of salaried tenured officials, hierarchically organized, loyal to their office, with impersonal relationships, governed by the rule of law, with authority clearly defined and limited by written rules and not standards (which allow personal discretion), characterized by specialization and expertise on the basis of efficiency and excellence. The members of the bureaucracy should be recruited and promoted according to objective criteria, based on formal qualifications (expert training and seniority) and competence, and not on status or patronage. In short, the four characteristics of bureaucracy should be hierarchy, impersonality, continuity and expertise.

The critiques of bureaucracy

Despite the ambitions of many governments and several theorists of rational and efficient governance (before and after Weber), bureaucracy was quite early identified pejoratively in the public mind with 'red tape' – inefficiency and

irrationality. This image is illustrated in the work of some of the best novelists and intellectuals of the nineteenth century, such as Balzac and Dickens (whose definition of bureaucracy as 'the Circumlocution Office' in *Little Dorrit* remains classic). In parallel, a number of liberal intellectuals (like J.S. MILL) foresaw the perils to representative democracy from an expansive bureaucratic state. The critique of bureaucracy from many fronts was so universal and overwhelming as to permanently associate bureaucracy with inefficiency, unresponsiveness, delay, partiality, irrationality, abuse of power, reactionism and corruption.

Furthermore, a number of theoretical and empirical studies have shown that the actual model of bureaucracy (both in theory and practice) was very far from Weber's ideal type. Organization theory detected that Weber's theoretical model was problematic for several reasons: (1) inflexible rules lead to inefficiencies and the need for more flexible standards for decision-making; (2) imperfect information and/or distorted views of society lead to unintended consequences and goal displacement; (3) bureaucrats are segregated in sub-groups with conflicting interests and goals, which leads to indeterminacy in their policy; (4) the bureaucracy has become a social class in itself, trying to maintain or expand its power by reproducing the needs for its continuance and remaining conservative; (5) the acquisition of official knowledge has resulted in a great asymmetry in information between agents inside and outside the bureaucracy, thus making the latter a powerful and uncontrollable caste, and (6) a ritualistic adherence to the rules and a narrow view of the problems due to excessive specialization precludes adaptation and synchronization with society's needs.

Despite these criticisms, the ideal type of bureaucracy envisioned by Weber became the signpost for the more-or-less successful organization of civil services in all Western democracies. The theoretical problems located in Weber's construction were also observed in empirical studies. However, bureaucracy should not be deemed a total failure, its main success being the operation of an increasingly

interventionist state with complex administrative tasks, even in times of political crisis. In fact, the absence of a well-organized bureaucracy during political turmoil is illustrative of its necessity. Thus, the theoretical and political attacks on the bureaucratic state have taken the form of an attempt to control it, not to demolish it.

The convergence thesis and the bureaucratic state

The expansion of bureaucratic power after World War II (coinciding with the expansion of the state) in Western democracies and the parallel developments in Eastern Europe led to the idea of a convergence between the two political systems, into a type of powerful bureaucratic state (an idea initiated by Weber himself). The increasing bureaucratization would supposedly result in rational and efficient decision-making and planning in a world of complexity, specialization and large-scale division of labour. Even though the convergence thesis has failed irrevocably, the emergence of the bureaucratic state is a reality.

The problematic nature of an expansive bureaucratic state had been predicted by Weber himself. Nevertheless, Gaetano Mosca, in his classic work *The Ruling Class* (originally entitled *Elementi di Scienza Politica*), had foreseen as early as 1884 that the modern state is evolving into an essentially bureaucratic state ruled by a minority. His theory – together with similar theories developed by Robert Michels and Vilfredo Pareto for political parties, the theories of managerial revolution by James Burnham, Adolphe Berle and Gardner Means and the theories critical to economic planning by F.A. VON HAYEK and Ludwig von Mises – shaped pessimistic views about the future of representative democracies. However, first Hayek and later Alvin Gouldner theorized, from different standpoints, the future failing of the bureaucratic state due to inefficiency (caused by the confines to autonomous choice) and imperfect information.

The Marxist critique

KARL MARX was one of the first thinkers (with Mill and Mosca) to criticize bureaucracy as an institution serving the interests of a class. However, by connecting bureaucracy with the ruling class and private CAPITAL, and describing it as their instrument, he failed to foresee its future expansion and usurpation of power in both Western and socialist societies (as Weber did). The development of bureaucracy into a new class with political power (even the ruling class in socialist states) was aptly described by Leon Trotsky and Milovan Djilas. For neo-Marxist writers, this 'betrayal of revolutionary ideas' characterized 'bureaucratic socialism'. Nevertheless, even thinkers like Herbert Marcuse adhered to the old Marxist view of bureaucracy as a form of capitalist domination with a class-coercive function. Thus, although they appropriately criticized the 'rationality of bureaucracy' concept of Weber, they rarely shared his (pessimistic) view of the emergence of the bureaucratic state.

Economic theories of bureaucracy

Neo-classical economic theory's view of bureaucracy as a budget maximizer (see NEO-CLASSICAL ECONOMICS) differs very little from sociological theory, although the bureaucratic method of economic organization appears as the exact opposite of the market and competition. For Ludwig von Mises, bureaucratic organization is not efficient *per se*, since it deviates from market-type decision-making. However, Ronald Coase has shown that hierarchy and vertical integration save in transaction costs and this is actually the cause of the emergence of firms.

According to the PUBLIC CHOICE (PC) THEORY, bureaucracies strive to maximize their pecuniary and non-pecuniary benefits (power and prestige) under budget constraints. Bureaucracy is essentially a MONOPOLY that sells its services to basically two buyers: the legislature and special interests.

Politicians are confronted with a principal-agent problem when they delegate their

bureaucratic authoritarianism

authority to bureaucracies to save in transaction costs, but also incur the danger of losing their control over bureaucratic policy. Politicians maximize their utility by controlling the promotion process in the civil service, externalizing the side-effects of unpopular policies (by passing the cost on to bureaucracy) and saving in transaction costs by delegating authority. In addition, as demonstrated by several empirical studies, incumbent political parties create new bureaucracies in order to ensure the continuation of their policies after their defeat.

Special interest groups are much better buyers of services than politicians. According to the capture theory (introduced by George Stigler), bureaucracies are 'captured' by special interests that can both influence legislatures to increase budgets for bureaucratic agencies, and 'influence' decisions by bribery and promotion by lobbying.

For public choice theorists, possible solutions to the problem of bureaucracy include the introduction of competition from different agencies that supply the same service, limits to spending and budget ceilings.

See also:

behavioural economics; bureaucratic authoritarianism

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ARISTIDES N. HATZIS

bureaucratic authoritarianism

'Bureaucratic authoritarianism' describes a type of capitalist state: it can be defined as a form of rule by the armed forces as a professional institution, implying the penetration of the state apparatus by its officials. It refers mainly to Latin American military dictatorships of the 1960s and 1970s. The Latin American countries turned away from democratic government, despite high levels of development. It is argued that the reason why Latin American countries abandoned democracy was, in fact, because of high levels of development.

The bureaucratic authoritarian state has as its antecedents the political mobilization of the working class and the transnationalization of

the economy. IMPORT SUBSTITUTION INDUSTRIALIZATION (ISI) caused the urban middle- and working-class to grow, and brought to power populist coalitions which deliberately activated popular forces through labour organizations and by including them in the political process. This development strategy ran into difficulties when the foreign exchange reserves accumulated during World War II were exhausted, and both prices and demands for Latin America's exports declined in the 1950s. The BALANCE OF PAYMENTS crisis caused domestic inflation to rise. The attempts to impose stabilization policies were opposed by labour movements and the main political parties. In these circumstances, the armed forces took control, in order to resolve the crisis of the state and restore the social relations that preceded ISI.

The main characteristic of the bureaucratic authoritarian state is, thus, a defensive reaction by the dominant class and its allies (mainly the armed forces) to crises involving a working class that has been politically activated and is increasingly autonomous with respect to the dominant classes and the state apparatus. The objective of this reaction is the political and economic subordination and control of the working class. That is, bureaucratic authoritarianism seeks to secure the political deactivation of the working class and the stabilization (or 'normalization' to use O'Donnell's term) of the economy.

This type of state is a system of political exclusion of a previously activated working class which is subjected to rigid controls designed to eliminate it from the political scenario. This is achieved by coercion and by the destruction of the resources that maintained the political activism of the working class, such as class organizations, political parties or social movements. It is also a system of economic exclusion of the working class. It means the restitution of the economic supremacy of the oligopolized and transnationalized sectors, such that they regain influence over the performance of the economy's main variables. It also implies the restoration of close links between the national economy and the world

economy. Since the implementation of the bureaucratic authoritarian state coincided with balance-of-payments deficits and high inflation, the control of inflation was a primary objective of this state.

The bureaucratic authoritarian state is highly autonomous in relation to society as a whole. Due to the circumstances in which it is implemented, the bureaucratic authoritarian state is a state for the bourgeoisie, since it supports and defends the basic and long-term interest of this class. However, it is not an apparatus colonized by the immediate interest of its various fractions.

The implementation of bureaucratic authoritarian regimes sought the economic exclusion and the destruction of the organizational instruments of the working class. However, in reality, the implementation of the export-led strategy damaged both the working class and the traditional sectors of the bourgeoisie producing for the domestic market. In order to maintain this strategy, the bureaucratic authoritarian state had to close all channels and institutions that permitted the representation of group or class interests. As a result, civil society was significantly weakened. In other cases, where bureaucratic authoritarian regimes were successful in generating industrialization, civil society grew stronger and the desire for liberalization and democratization re-emerged.

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business cycles

The 'business cycle' – also referred to as the 'trade cycle' – is at the very core of the science of modern economics. One can, in fact, say that it is the economic process around which the study of macro-economics is oriented. Not only is it the principal means of assessing the performance of a national economy over time, but it has also become a crucial measuring stick for judging the success of macro-economic policies. The business cycle is defined as the systematic path that the overall economic activity of a nation will take over a certain time-period. The use of the term 'cycle' should not be interpreted as conveying a regular, steady or uniform path in business activity: empirical studies of the business cycle definitively show that it is anything but regular, steady or uniform. The phases are not symmetrical and the path is neither continuous nor predictable. The systematic quality of the fluctuations is instead characterized by recurrence: an ongoing alternation between a phase of economic expansion or boom – when we are moving from a low point of economic activity (a trough) to a highpoint (a peak) – and a phase of economic contraction or recession – when we are moving from a highpoint of economic activity to a lowpoint. Peaks and troughs are referred to as turning points in the business cycle.

History of economic thought on business cycles

Early thinking on the issue of business fluctuations tended to be oriented around the

identification of LONG CYCLES. Long cycles were observed by Tugan-Baranovsky (1894), Aftalion (1913), Lenoir (1913), Van Gelderen (1913), Helphand (1901), Jevons (1878) and Wicksell (1898). The most celebrated contributions to the identification of long cycles came from Clemont Jugler, Joseph Kitchen and Nikolai Kondratieff (see KONDRATIEFF WAVES). In 1860, Jugler published a study identifying nine- to ten-year cycles in prices and output in France, Great Britain and the United States. Output co-varied positively with inflation over the cycle, as periods of expansion were brought to an end by a contraction of the money supply (in this case initiated by banks reacting to excessive demand for money balances). In the 1920s, both Kitchen and Kondratieff identified cycles of fairly long periodicities in respective countries. Kitchen identified minor cycles of forty months and major cycles of seven to eleven years in the British and US economies of the late nineteenth and early twentieth centuries. He attributed fluctuations, in large part, to psychological reactions to production in capitalist economies. Kondratieff's famous study of long waves identified fifty- to sixty-year periodicities in the cycle of prices and output of capitalist economies from the eighteenth to the early twentieth centuries. Kondratieff was the first economist to provide a thorough statistical analysis of the long cycle. Like Jugler, he found that prices moved pro-cyclically with output over the cycle. The explanation he offered for the long cycle centred around fluctuations in the investment in capital goods. Fluctuations depended on the supply and demand for money (the two crucial variables determining supply and demand being savings and interest rates).

While the early work on business cycles was more concerned with statistically representing the periodic structure of fluctuations, the later work was more systematic about explaining underlying causes of the fluctuations. A more analytical wave in the study of business cycles emerged in the 1930s and 1940s. J.M. KEYNES, in his *General Theory* (1936), saw turning points in the cycle being driven by overly

optimistic (in an upswing) and pessimistic (in a downswing) expectations about the profitability of investment. In the landmark two-volume study *Business Cycles* (1939), JOSEPH SCHUMPETER proposed that the business cycle was a natural consequence of the investment process in capitalist economies. Upswings were characterized by an upsurge of innovation in the capital stock. An expansion becomes self-reinforcing as rising prices (from an expanding money supply) lead to overly optimistic investment. The process runs its course and a downswing ensues as excess capacity (from over-investment) and/or credit contraction (rising interest rates) lead to a collapse in investment. Haberler's (1937) explanation of the business cycle recalled Pigou's 'real balances' effect, which essentially said that shifts in the price level would change the real wealth of individuals, such changes inducing concomitant shifts in their consumption of goods. It was also in the 1930s that the groundwork for the modern econometric study of business cycles was laid by Ragnar Frisch (1937) and JAN TINBERGEN (1939), both of whom shared the first Nobel Prize in economics in 1969. They were the first to attempt to mathematically model the business cycle as a dynamic process. Frisch's emphasis on the interaction of external shocks and propagation mechanisms still forms the core of the current study of business cycles.

More contemporary thought on the business cycle has featured contributions in four main areas: the interaction of multipliers and accelerators (see ACCELERATOR PRINCIPLE; MULTIPLIER PRINCIPLE), rational expectations, the inventory cycle and the real business cycle. Early work on multiplier-accelerator interaction by Harrod (1936) and Samuelson (1939) emphasized the relationship between consumption and investment as a driving force of the business cycle. Investment in the capital stock essentially tracks changes in consumption, which in turn depend on the last period's income. Hence, investment responds proportionally to changes in income, the exact relationship being determined by the change in income multiplied by the size of the

coefficient measuring investors' response to the change (that is, the accelerator coefficient). Changes in the cycle emanate from changes in the components of national income. For example, an expansion in the cycle might be stimulated by the investment consequences of a rise in government transfer payments. In this respect, the interaction model is a self-contained dynamic, most representative of the modern analysis of business cycles, as changes in income in the present time are driven by past values.

Pioneering work on the inventory cycle was done by Lundberg (1937), Metzler (1941), Abramovitz (1950) and Lovell (1962). According to this version, the fundamental movements in general business fluctuations track cumulative decisions on the part of firms to either run down or build up their inventories. While inventories have historically comprised a small proportion of GROSS DOMESTIC PRODUCT (GDP), many economists have come to see them as a strategically important propagating mechanism driving overall business conditions. Growth is dependent on investment in inventories, which itself is dependent both on actual sales and expectations of sales. When sales, for example, exceed expectations, firms may choose to add substantially to inventories by longer production runs and this, in turn, fuels an expansion. As in the multiplier-accelerator model, growth exhibits a strong self-reinforcing process as output in the present time relies heavily on past consumption.

The rational expectations approach to the business cycle, also called the 'New Classical School', came out of the work of Muth (1961), Lucas (1972) and Sargent and Wallace (1975). It is founded on the assumption that economic actors efficiently use all available information in constructing forecasts of future economic outcomes and that they adapt their behaviour to these forecasts in a rational maximizing way. This adaptive behaviour will cause the growth path of an economy to gravitate closely to the full-employment level. In fact, shocks to the economy will only have a real impact on growth if actors either misperceive the shocks or miscalculate the macro-economic impact of

those shocks. To use a classic example, a government may try to stimulate growth by increasing the money supply, but if both labour and firms correctly anticipate and rationally adapt to inflation (that is, correctly perceive that no relative changes have occurred in the prices of their labour and goods), neither will be encouraged to increase their economic activity. The resulting implication is that monetary shocks which are anticipated and adapted to, have no real effect on growth (they merely affect the level of inflation). Only unanticipated shocks (that is, surprises) can promote economic growth.

Real business cycle theory, as developed by Kydland and Prescott (1982) and Prescott (1986), underscores the importance of shifts in the demand for labour. Changes in the labour-demand function of an economy will lead to predictable outcomes in employment: an expansion will result in higher employment (given a fixed supply function) which in turn leads to higher growth, while a contraction of the demand for labour leads to a recession. Shifts in labour-demand, in turn, are driven by changes in productivity, as the labour-demand schedule essentially represents the marginal product of labour. In this version, much emphasis has been placed on technological innovations (real shocks) as the principal source of shifts in labour productivity. Hence, robust innovation characterizes a booming economy, while recessions are accompanied by sluggish innovation.

Political business cycles

A growing literature has emerged on the specific relationship between the systematic structure of economic growth and politics: that is, political business cycles. Although Kalecki (1943) wrote the seminal work on the subject, it was Nordhaus' (1975) landmark contribution which attracted the most significant attention to the political causes of economic fluctuations. Nordhaus saw the business cycle as conforming to the election cycle in a democracy. In this view, politicians manipulate the macro-economy to maximize the likelihood of re-election.

Assuming that people vote based on short-run economic performance, Nordhaus hypothesized that politicians could maximize votes by carefully timing short-run inflation/unemployment trade-offs across their terms in office. They could generate voter support by inflating the economy, and thus increasing employment, in the latter part of their terms (that is, shortly before the new election period) and use the safety of the early term to limit output so as to keep inflation in check. Other work has expanded the range of macro-economic tools which can be used to bring business and election cycles into conformity. Tufte (1978), for example, highlights the strategic importance of manipulating short-run disposable income by altering the timing of transfer payments. Such payments are just some of the resources that governments can distribute to condition voters' allegiances, others being taxes, public works projects and jobs.

Gallarotti (1985) has explored the international political economy of the business cycle. Here, the business cycle is analysed as an independent variable: economic fluctuations explain changes in the trade policies of nations (see *TRADE POLICY*). Economic expansion encourages political coalition dynamics that move policy in a free trade direction, as an upswing increases the political power of free traders relative to protectionists. Economic contraction gives the political edge to protectionists, thus moving policy away from free trade.

See also:

depressions; economic growth; Great Depression; political business cycle; rational expectations

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GIULIO M. GALLAROTTI

C

Cambridge School

The Cambridge School has its roots in that branch of economics founded by ALFRED MARSHALL (1842–1924) and made famous by JOHN MAYNARD KEYNES (1883–1946). While this 'Cambridge School' encompasses a distinct economic doctrine, methodology and research agenda, the term is usually applied to a more modern group of economists at Cambridge University who either worked with Keynes or were deeply involved in the Keynesian revolution. Among others, this group includes NICHOLAS KALDOR, Joan Robinson, PIERO SRAFFA and L.L. Pasinetti. An American branch of the school often refer to themselves as 'post-Keynesians' (see POST-KEYNESIAN ECONOMICS). Both groups address long-run problems of growth and income distribution that Keynes largely neglected. Over the years, the Cambridge and post-Keynesian Schools have been at odds with the more conventional neo-classical theory of production and distribution associated with diminishing marginal physical products, technical substitution, competition and optimizing, where factor prices are determined by their relative scarcities (see NEO-CLASSICAL ECONOMICS).

In Solow's neo-classical growth model, the long-run equilibrium growth rate is exogenous, set by the rate of growth of the labour force (and the exogenous rate of technical progress). The rate of profit is then endogenous, determined by this rate of growth, technology and the rate of saving of the economy. In the so-called 'new neo-classical growth models', these relationships are reversed. When these models are reduced to their bare essentials, the steady-state rate of profit is the exogenous variable,

while the rate of growth becomes an endogenous variable, entirely determined by the product of the profit rate and the given savings rate.

In contrast to the above neo-classical views of growth and distribution, the Cambridge School assumes constant or increasing returns to scale, fixed technical coefficients, imperfect competition, behaviouralistic 'rules of thumb' and a macro-economic theory of income distribution. In the Cambridge models of growth and distribution, the rate of profit is a macro-economic variable, thus avoiding the drawbacks of assuming (as did the earlier neo-classical models of growth) that the rate of profit depends on the scarcity of capital relative to labour – a hypothesis that was shown to be based on dubious grounds during the capital controversies of the 1960s (Harcourt, 1972). The other crucial feature of Cambridge models is the presence of an independent investment function, which ensures that growth rates are endogenous variables. By contrast, neo-classical growth models generally assume that investment is driven by savings, even when steady-state growth rates are endogenous. While the old neo-classical models of the Solow type assumed more specifically that full-employment savings were the driving force.

In the models first proposed by Joan Robinson and Nicholas Kaldor, when savings out of wages are assumed away, the rate of profit of an economy only depends on its rate of accumulation and the propensity to save out of profits, to the exclusion of any other variable. Pasinetti (1962) generalized this result by noting that workers could earn both wages and profits, thus distinguishing between workers on the one hand and capitalists on the other, the latter earning only profits. Various

neo-classical authors, such as Samuelson and Modigliani (1966), objected to what became known as Pasinetti's Paradox, that the long-run rate of profit of an economy depends only on its rate of growth and the propensity to save of the capitalist class, to the exclusion of any other variable, including technological coefficients and workers' propensity to save. Neo-classical authors countered Pasinetti's Paradox by showing that Pasinetti's result was just one of two possible regimes. They derived a second long-run equilibrium, where the propensity to save of the working class compared to that of the capitalist class would be such that the latter class would eventually disappear. With this 'anti-Pasinetti regime', as it was called by Kaldor, a way seemed open for reinstating marginal productivity analysis based on the flexibility of technical coefficients.

Whereas Kaldor's (1966) article is generally regarded as a neat reply to the empirical arguments supporting the likelihood of the anti-Pasinetti regime in long-run models of balanced growth, it is also seen as a compromising concession to the neo-classicals, because it incorporates an adjusting mechanism between savings and investment – the valuation ratio – which appears to be similar to the neo-classical interest rate mechanism.

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ROBERT LOONEY

capital

'Capital' is one of the least understood and perhaps most contradictory notions in the study of political economy, often left out of financial dictionaries as a consequence. In the orthodox account, capital is the unspent or accumulated wealth or endowment of a company or individual. This wealth is separate from working capital, which can be defined as the excess of *current* assets over current liabilities. The mainstream account includes both financial resources and physical assets (such as land and plant) in its definition of capital. Central to this view is the idea that capital is equivalent to things, like money or machine tools, that might be used in the making of more capital.

The critical account of capital has its roots in classical political economy and the writings of KARL MARX in particular. In this view, capital is understood as a social relationship between producers and those who own the means of production and thereby have power to alienate products of the labour process. The EXPLOITATION that Marx identified, premised on the LABOUR THEORY OF VALUE derived from classical political economy, gives rise (he suggested) to a socioeconomic mechanism – capital – with its own laws of motion.

For the most part, the specifics of the critical approach to CAPITAL MOBILITY have fallen out of favour with social scientists, including scholars in international political economy (IPE). What remains useful in this alternative view is the idea that there is a social mechanism at the heart of CAPITALISM, reinforcing the idea that economic and financial relationships are inherently contestable.

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capital adequacy standards

Capital adequacy standards are a method of regulating financial firms. Internationally, these have primarily been developed for banks by the BASLE COMMITTEE ON BANK SUPERVISION, a committee of the GROUP OF 10 (G-10). Efforts to develop capital adequacy standards for securities firms at the INTERNATIONAL ORGANIZATION OF SECURITIES COMMISSIONS (IOSCO) have been less successful.

At the end of the 1970s, the Basle Committee initiated work on capital adequacy standards, culminating in an agreement in 1988. The agreement basically requires banks to hold capital (mainly defined as shareholders' equity) equal to or greater than 8 per cent of bank assets (mostly loans). Five categories of assets were each assigned different weights to reflect variations in their riskiness. For instance, loans to ORGANISATION FOR ECONOMIC CO-OPERATION AND DEVELOPMENT (OECD) governments were weighted at zero, requiring no additional capital to be held, while loans to corporations were weighted at 100 per cent. Capital, which can be viewed as the difference between assets and liabilities, provides a cushion against insolvency. Before the 1988 agreement, competitive pressures had led to a downward trend in capital asset ratios as banks pursued a strategy of high-volume expansion of assets, many of which had poorly defined risks. The need to hold higher levels of relatively expensive equity reined in this expansion.

Although it is generally accepted as a positive step there have been criticisms of the 1988 agreement for not being flexible enough to capture variations in riskiness within its five categories of assets and for not incorporating other important risks such as market fluctuations (particularly important as banks have

become more involved in DERIVATIVES markets). The Basle Committee has therefore subsequently worked to further develop the agreement. In 1995, new procedures were developed which permit banks to determine appropriate levels of capital based on their own internal risk-management systems, rather than on the Basle Committee's more broad-brush approach. The predictions of those systems will be monitored and penalties, in the form of higher multiples of required capital, will be imposed if it is subsequently determined that the system has failed to accurately predict losses in a bank's portfolio. The Basle Committee has also been working with IOSCO to develop capital standards for securities firms.

Two political issues stand out with regard to international capital adequacy standards. First, this coordinated regulatory initiative contradicts the view that strengthened regulation is unnecessary and impossible in an era of financial globalization. Second, like any international agreement, there is an interesting mixture of power politics and collaborative institutions and practices. The enduring power of states is highlighted by Ethan Kapstein (1994) who stresses the role of the United States in pushing the negotiations forward in 1986 and 1987. In contrast, Tony Porter (1993) emphasizes the relative autonomy from power politics of the regulators involved in the Basle Committee's ongoing work.

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TONY PORTER

capital, controls on

There is a widespread perception among both economists and scholars of international political economy (IPE) that the process of FINANCIAL INTEGRATION has increased the fragility of the international monetary system and the volatility of exchange rates. This is a consequence of the technological as well as technical developments that have contributed to the establishment of an integrated financial market, but also of the policy choices made by the national governments in the 1980s in relation to the LIBERALIZATION of capital markets.

In fact, in a Mundell–Fleming world (see MUNDELL–FLEMING MODEL), characterized by perfect capital mobility, there is a sort of trade-off between the stability of exchange rates and the possibility of implementing independent monetary policies – that is, using the interest rates as monetary policy instruments (see MONETARY POLICIES). The solution to this problem can be found in the creation of a regional monetary union, as in the case of the establishment of the ECONOMIC AND MONETARY UNION (EMU). In this case, the instability problems of the financial area considered are eliminated by establishing a single currency area with all that it implies in terms of abolition of independent exchange rate and monetary policies.

Alternatively, the reintroduction of capital controls could be proposed. The best known of these proposals is the one put forward by Tobin, in the late 1970s, which reappeared in different forms more recently. The idea is to impose some form of taxation on all foreign exchange transactions – for example, a 1 per cent tax. The principle underlying this proposal is very well known and can be summarized with the expression ‘putting sand in the wheels of international finance’. It consists of stopping international speculators from attacking a currency without any apparent motivation. The basic underlying assumption is that a tax on short-term foreign exchange transactions will stop or reduce short-term capital move-

ments (which are often self-fulfilling speculative movements) without restraining long-term capital movements from moving according to the performance of fundamentals. A similar result could also be obtained by imposing a requirement on banks to deposit the counterpart of their net foreign exchange exposure in an interest-free account at the central bank.

These proposals were actually put forward to solve the instability problems of regional exchange rate agreements like the EUROPEAN MONETARY SYSTEM (EMS). Of course, within a currency area like EMU the reintroduction of capital controls is not an issue, but they could be used as a tool to control the external value of the euro, that is its value *vis-à-vis* other currencies like the dollar or the yen.

In general, economists have raised a number of objections to the above mentioned proposals to reintroduce controls on the mobility of capital. These objections are related on one side to the feasibility of the reintroduction of capital controls and on the other side to their effectiveness in actually restraining speculative attacks and, thus, in stabilizing the international monetary system. The practical problems of such arrangements look somewhat insurmountable. Indeed, the idea of taxing all exchange rate transactions with the aim of stopping short-term speculation is, first of all, very difficult to put into practice given the existence of a clear free-riding problem (see FREE RIDER PROBLEM). This consists in the impossibility of getting all governments in the world to agree on imposing the same level of taxation to their foreign exchange markets. There will always be a government which will provide a taxation-free haven for short-term speculative capital to be invested in its foreign exchange market, thus posing unbearable competitive threats to the other countries’ financial centres. Besides, even in those countries where this taxation is eventually imposed, speculators will be able to resort to other markets different from foreign exchange ones (like the swap market, for example), thus circumventing the restrictive legislation. Therefore, even if the imposition of capital controls could, in theory, restrain speculators from

creating instability in the international foreign exchange market, it would be quite unlikely to be put into practice.

However, many objections also arise in relation to the fact that the proposal would not work in theory. In addition to the fact that not all economists believe that the wave of capital liberalization is the only source of destabilization of the financial markets, many scholars (particularly those linked to the study of IPE) point out that the process of integration, or GLOBALIZATION, of financial markets has created a very unstable monetary environment, which has even been conceptualized as CASINO CAPITALISM. However, the sources of this instability are traced in a number of factors which are not going to be eliminated by the mere reintroduction of capital controls. Among these factors, the most apparent is certainly technological progress, with all that it implies in terms of the elimination of temporal and spatial constraints to capital movements. Technological achievements also render it increasingly difficult to actually control capital movements: their sources, their final destinations and the intermediary channels they pass through in the financial markets. Moreover, the developments of new FINANCIAL INSTRUMENTS and techniques, have added to the complexity of the international financial system, as well as increasing the possibility for speculators to circumvent existing regulation.

Of course, none of this means that international monetary, as well as political, authorities should avoid tackling the problem of international monetary instability, but they must tackle it by adopting a more systematic and global approach than the one underlying the mere reintroduction of capital controls.

See also:

capital markets; finance capital; financial instruments

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L.S. TALANI

capital flight

Capital flight occurs when individuals or firms believe that they can obtain a better return for their money in another country when compared to the one in which their funds are currently held. This can be due to such factors as overvalued exchange rates (making foreign assets appear cheaper), a fear of exchange-rate devaluation, high and fluctuating rates of INFLATION, an unfavourable change in taxation policy, domestic political instability or the corrupt obtaining of money followed by the desire to 'launder' it abroad. In the vast majority of cases of capital flight, the money leaving the country is that of foreign investors and foreign creditors, rather than that of domestic agents, chiefly because such investors are less concerned about capital remaining in a particular currency for reasons of convenience. In addition, foreign investors and creditors will be much more seriously affected than their domestic counterparts by factors such as the introduction of restrictions on foreign exchange.

As a general rule, capital flight appears to take place in waves, rather than continuously. This reflects a lack of continuity in the probability of possible 'negative states of the

world' becoming reality. For example, if foreign investors receive information that may be pertinent to the future performance of a particular currency, this will cause them to revise their share of so-called 'hedge assets' (usually foreign) in their investment portfolio (see HEDGE FUNDS). Waves of capital flight become apparent during such periods of portfolio adjustment, subsiding again once the adjustment process is complete.

The earliest 'modern' example of capital flight was during the Franco-Prussian War, when French funds were transferred to London. A significant amount of capital flight also took place during and between the two World Wars, as the risks of war in Europe led investors to transfer money to more stable areas, such as Switzerland. It was during the 1980s, however, that the phenomenon took on particular relevance for the international political economy (IPE) theorist, because one of the more bizarre features of the DEBT CRISIS in developing countries was the incidence of capital flight.

During the debt crisis, countries that were deeply in debt were forced to borrow increasing amounts of money in order to finance these debts. However, much of the money that was borrowed, rather than being used to pay previous debts or to restructure their economies, was simply either deposited by private individuals and firms in foreign banks, or was used to buy foreign property or stocks and shares. For example, there is evidence that, up to 1982, for every dollar lent to some of the most indebted countries (including Brazil, Mexico, Peru and Venezuela) an average of thirty cents flowed back as capital flight. Moreover, between 1975 and 1985 an estimated \$165–200 billion were placed by individual investors from developing countries in international financial markets. In many ways, this was not surprising, given that many developing countries are unbankable in the traditional sense of the term. Because developed countries tend, on the whole, to offer a safer return on investment in comparison to developing countries, it is more likely that the elites in developing countries will buy securities in the

global marketplace rather than in their own national markets. However, by the end of the 1980s, the international banking community had begun to identify the phenomenon of capital flight as both a cause and a consequence of the continuing debt crisis. This is because capital flight can be so significant as to cause national economic collapse.

For example, a country finding that capital is fleeing across its borders to another may find that foreign loans are impossible to obtain; that their official foreign exchange reserves have been exhausted in an effort to prop up the economy, and that interest rate increases (which in principle might stem capital outflows) are no longer feasible due to the fact that they would intensify deflation. In turn, such an unstable economic position could increase the risk of domestic political turmoil or the collapse of the domestic banking system. Indeed, the ironic element of capital flight is that measures against it might actually increase its extent. For example, domestic investors would realize that there would be a decline in the level of foreign currency holdings within their country that could go on for some time and would want to raise the proportion of foreign currency in their own portfolios. This might occur to such a degree that foreign holdings are accumulated by domestic investors to a level much higher than is justified simply on the evidence of the existing risk.

Governments thus sometimes pre-empt a forced bankruptcy by both agreeing a voluntary rescheduling arrangement with foreign creditors and imposing a variety of controls on domestic capital. Such measures are nevertheless costly. The country's credit rating could be adversely affected for a significant time period and, indeed, a country with a tradition for economic and political liberalism might find its reputation damaged irreparably if it undertakes measures that are designed to prevent domestic citizens from following individual investment policies that will protect their private wealth. In general, however, measures that are taken to protect against capital flight are ineffective, unless they are policed by methods that are inconsistent with

economic conduct in a liberal society. There are, however, loopholes: traffic in banknotes is one (particularly if the given country has land frontiers and is a tourist centre), as are false invoicing in trade and compensation payments. Such economic behaviour often lies behind the substantial negative 'errors and omissions' items in BALANCE OF PAYMENTS statistics for countries that are susceptible to capital flight. In addition, they may also be responsible for the positive 'errors and omissions' items for those countries that are, on the other hand, receiving flight capital.

See also:

arbitrage; exchange controls; globalization

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capital, internationalization of

The internationalization of capital is a phenomenon of the nineteenth and twentieth centuries. The preceding two centuries witnessed the international mobility of merchant capital, but only by the mid-nineteenth century were capital markets well enough established to finance long-distance trade, foreign government debt, industrial enterprise, and transport and communications infrastructures – all on a global scale. The centre of international capital was the City of London (see LONDON, CITY OF). Most of the capital raised for foreign investment was of the portfolio type (that is, without an interest in directly managing or controlling the investment from abroad), but an increasing amount was in the form of

manufacturing direct investment (involving managerial control).

The debt legacy of World War I, political and economic instability, the prolonged Depression and increasingly tight national controls, throttled the flow of capital across borders in the inter-war years. The Bretton Woods agreement of 1944 sought to 're-internationalize' capital flows, but in a very qualified sense: cross-border current account transactions were encouraged to revive international trade; but stringent capital account controls were sanctioned in order to protect national demand-led and interventionist economic policies (see BRETTON WOODS SYSTEM). AID flows to Western Europe and developing countries, not private flows, dominated international capital transactions well into the 1950s.

Private international capital flows substantially accelerated from the late 1950s, particularly with the unanticipated take-off of offshore currency, bond and equity markets (see BONDS; EQUITIES; OFFSHORE FINANCE). Since then, the volume and speed of international mobile capital has increased enormously, although it is debatable whether international financial market integration has yet reached the levels seen in 1913. One major difference between the modern era (from the 1970s) and the pre-1914 era is that financial lending is now much more short-term oriented in an environment of floating (and sometimes volatile) exchange rates (see EXCHANGE RATE), whereas the *PAX BRITANNICA* was characterized by the movement of long-term capital in a climate of short-term exchange rate stability under the GOLD STANDARD. The last two decades have witnessed the dismantling of national capital controls, at least in part due to the greater ease by which international capital flows can evade local restrictions.

FOREIGN DIRECT INVESTMENT (FDI) has also grown substantially, most noticeably with a surge in the 1980s. By the mid-1990s, while still overwhelmingly concentrated in developed countries, FDI going to (some) developing countries had significantly increased. Some analysts have gone as far as saying that FDI ranks alongside (and perhaps has even overtaken) trade as an engine and handmaiden of

capital, law of the concentration of

growth. However, a note of caution is in order in gauging the impact of FDI on domestic economies: it is estimated that three-quarters of the value added of MULTINATIONAL ENTERPRISES is still located in home countries, and FDI still only accounts for about 4 per cent of fixed domestic capital formation.

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RAZEEN SALLY

capital, law of the concentration of

The law of the concentration of capital is attributed to MARX and is derived from the process of the accumulation of capital. According to Marx the hallmark of the individual behaviour of capitalists is the pursuit of profit, which forces them into two kinds of struggles: the first in the labour process against workers over wages and conditions of work, and the second against other capitalists over the expansion of the market share at the expense of their competitors. The way that capitalists succeed in these two kinds of struggles is through the introduction of more fixed capital. As a consequence, the mechanization of the labour process raises the productivity of labour; at the same time, the introduction of fixed capital, on one hand, increases the minimum efficient scale of operation and, on the other, reduces the unit cost of production.

The latter implies that innovating firms, by reducing their prices, manage to eliminate the less efficient firms. Thus the process of capital accumulation leads to a small number of firms holding an increasing share of the total market. This is the reason why the concentration of capital is the expected outcome of accumulation and the operation of competition.

These developments by no means imply that the concentration of capital diminishes competition; on the contrary, the cause of mechanization (which is the pursuit of profit as a purpose in itself) continues to exist even though the number of firms diminishes, and competition among the remaining firms for the expansion of the market share becomes even more intense. Only in the neo-classical notion of PERFECT COMPETITION (a purely static concept completely alien to classical economists and Marx) is the intensity of competition directly related to the number of firms so that the concentration of capital diminishes the intensity of competition (see NEO-CLASSICAL ECONOMICS).

Another related development – which simultaneously takes place as a result of the nature of capital and the operation of competition – is the ever increasing minimum efficient scale of operation requiring higher investment which firms (especially small ones) cannot undertake and thus they may merge or become the targets of takeovers. The resulting growth of the scale of production through the amalgamation of capitals is called 'centralization of capital' and is another aspect of the operation of competition. The credit system facilitates this process and, therefore, accelerates the process of the concentration of capital.

See also:

disproportionality; finance capital; Marxian economics; monopoly capitalism; overproduction

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LEFTERIS TSOULFIDIS

capital markets

Capital markets are markets buying in securities. Securities may be broadly divided into two categories: stock or shares (which may be both equity – see **EQUITIES** – and preference) and bonds or other debt instruments.

An equity (or an ordinary stock or share) represents a share in the ownership of a company. The equity shareholders jointly own the company and have the right to vote at general meetings. The law requires that the company keep shareholders informed about its economic performance through the publication of an annual report and accounts. They are entitled to dividends, but only after all other creditors have been paid, and if the company makes a loss, their shares fall.

Bonds are fixed interest securities, which entitle the owner to regular payments of interest and to the eventual repayment of the initial sum lent. This interest payment is known as the coupon and it is usually paid every six months, while the par value of the bond is repaid at its maturity. Bonds can be classified according to the length of their maturity.

Bondholders' claims have precedence over shareholders. This is why share-holding is riskier than bond-holding. However, shareholders are entitled to greater benefits when the company's shares increase their value, while bondholders are entitled only to a fixed return on their investment. The proportion of bond-finance to equity-finance within a firm is called its 'debt equity ratio' or 'gearing'. Bonds are issued by commercial undertakings and by governments, municipalities and other public bodies, including international organizations, whereas shares may only be issued by commercial undertakings.

Capital markets provide an alternative and cheaper way of raising funds to the banking system. Although primitive capital markets go

back to antiquity, they grew in importance during the settlement of new territories in the United States, Australasia and South America during the nineteenth century. Periodic defaults on debt (such as in the 1930s) have tended to make investors wary of risk and give rise to greater regulation of these markets.

Capital markets tend to be more efficient than banking because borrowers and lenders are able to meet directly, avoiding the cost of the banks' intermediation between them. But doing without banks creates an information problem, which credit-rating agencies attempt to solve with their judgements on the likelihood of the debtor repaying obligations.

The deepest capital markets are located in the United States, on Wall Street. The demand for these funds means that US and foreign companies have to meet the exacting US disclosure requirement of the **SECURITIES AND EXCHANGE COMMISSION**. Outside the United States, the most important sources of capital are the **EUROMARKETS** located in London.

As a consequence of the inherently more efficient nature of capital markets and the intense demand for transparency in the wake of the Asian financial crisis, the future is likely to see growth in capital markets as compared to traditional bank lending, especially in Asia and Europe.

See also:

capital, controls on; clearing; financial instruments; futures; investment banks; London Metal Exchange; merchant banks; parallel markets; primary markets; stock markets; underwriting

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L.S. TALANI

capital mobility

Capital mobility refers to the capacity of FINANCE CAPITAL to move, especially across jurisdictional boundaries. Put differently, capital mobility refers to the relative absence of friction on financial flows across borders. This *capacity* of capital to cross boundaries may not manifest itself at any given moment, however, due to the (relative) absence of profit incentives deriving from differential rates of expected return in different jurisdictions; mobility should therefore be distinguished from actual flows of money.

At the international level, the relevant jurisdictions are states, most of which possess their own currencies. As a consequence, capital mobility can have important implications for an individual state's BALANCE OF PAYMENTS position. Importantly, international capital mobility has increased significantly since the establishment of the BRETTON WOODS SYSTEM in 1944 (especially for short-term financial assets); indeed, the founders of Bretton Woods had relied on suppression of international capital movements for the proposed system of internationally pegged exchange rates to function properly. The collapse of the Bretton Woods system in the early 1970s can be at least partly attributed to changes in interna-

tional capital mobility or, put differently, to heightened international FINANCIAL INTEGRATION.

At least three distinct causes, or types of underlying causes, of this increase in the degree of capital mobility can be identified. First, advances in communications and information technologies have facilitated private international capital transactions. Second, innovation by financial firms – at least partly in response to technological advances – has produced new instruments capable of facilitating the flow of capital across borders. (This includes, but is not limited to, the development of international or so-called 'euro' money markets, established to operate beyond the normal purview of national authorities.) Finally, the liberalization of domestic capital markets – the removal of legal and technical barriers to international capital mobility – by the political authorities of many of the world's countries has dramatically reduced the friction of international capital movements.

A growing cohort of academics has recently examined the effects of increased capital mobility on politics and policy. Much of this recent work owes a great intellectual debt, directly or indirectly, to the pioneering studies of Robert Mundell and Richard Cooper (see Cooper, 1968; Mundell, 1968). Mundell recognized that three key objectives of governments – exchange rate stability, private capital mobility and domestic monetary independence – could not be achieved simultaneously except on an episodic basis. Recognition of the mutual incompatibility of these three policy objectives has since been variously referred to as the Mundell-Fleming approach (see MUNDELL-FLEMING MODEL), the Unholy Trinity and the Inconsistent Quartet (the latter formulation paying explicit attention to the role of international trade as an additional variable). Cooper then explored the broader policy implications of Mundell's analysis and of ECONOMIC INTERDEPENDENCE more generally.

Mundell's analysis was rooted in the observation that the independent pursuit of macro-economic policies by different national authorities (see MACRO-ECONOMIC POLICY) can

produce incentives for financial assets to flee some jurisdictions in search of higher rates of return elsewhere. To the degree that assets are mobile, differential rates of expected return can generate substantial capital flows across international borders; unless these financial flows are counterbalanced by opposing movements on the current account, they will necessarily generate FOREIGN EXCHANGE market disequilibria (that is, excess supply or demand in the foreign exchange market), which will in turn require either official intervention or an adjustment of the exchange rate. Thus, to the degree that capital is freely able to traverse international borders, a direct trade-off exists between exchange rate stability among states and their pursuit of independently chosen macro-economic policies (and especially MONETARY POLICIES).

Recently, a growing popular literature on international financial integration (as well as some of the literature on GLOBALIZATION more generally) has drawn sometimes loose and often insupportable conclusions about the policy implications of capital mobility. It is not uncommon, for example, for it to be suggested that states have completely lost control over national macro-economic policy and that they no longer exercise sovereignty with respect to these matters. Often these contentions are supported by unrealistic assessments of the nature of autonomy exercised by states over the past generation, by conflating capital mobility with capital flows or by maintaining that capital is now perfectly mobile across states.

More careful examinations reject these extreme claims, but are nonetheless interested in the implications of heightened capital mobility for politics and governance. Recent scholarly studies have focused on such matters as the degree to which national economic policies have been influenced by the heightened threat of CAPITAL FLIGHT and (relatedly) of exchange rate crises; the implications of rising capital mobility for the political power of different groups, both within and between states; the impact of international financial integration on

the WELFARE STATE; the relationship between capital mobility and income inequality, both nationally and internationally, and the ways in which the trend towards greater capital mobility might be slowed (or even reversed).

See also:

capital, controls on; capital markets; exchange controls

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DAVID M. ANDREWS

capitalism

'Capitalism' is one of the most hotly contested terms in social science. It may be broadly defined as a distinct, historically specific form of social organization, based on generalized commodity production, in which there is private ownership and/or control of the means of production. The word 'capitalism' is a relative latecomer in social science, with the *Oxford English Dictionary* citing its first use in 1854. Initially popularized by Marxist writers (KARL MARX himself preferred to speak of the 'capitalist mode of production' or 'bourgeois society'), it is a term which has increasingly gained credence across the political spectrum, although this has inevitably produced inconsistency in its employment. At least three present day usages are discernible.

The first, and most popular, is the meaning derived from the work of Werner Sombart and MAX WEBER. Sombart describes capitalism in terms of a synthesis of the spirit of enterprise with the 'bourgeois spirit' of calculation and rationality. This *geist* or spirit is deemed to be an aspect of human nature and is seen to have finally taken a suitable form for itself in the shape of the economic organization of modern society. On this basis, Weber charts (in *The Protestant Ethic and the Spirit of Capitalism*) how the 'spirit of capitalism' transformed other 'older' modes of economic activity designated by the term 'traditionalism'. A 'traditionalistic' worker does not consider maximization of the daily wage as a primary objective, but opts instead to work to secure an accustomed style of life: 'A man does not "by nature" wish to earn more and more money, but simply to live as he is accustomed to live and to earn as much as is necessary for that purpose' (Weber, 1930: 60). The capitalist enterprise, by contrast, is based on a rational reorganization of production and is directed solely towards maximizing productive efficiency. In this system, 'Man is dominated by the making of money, by acquisition as the ultimate purpose of his life. Economic acquisition is no longer subordinated to man as the means for the satisfaction

of his material needs' (ibid.: 53). Although Weber stops short of suggesting that the Protestant ethic produced capitalism, he believes that the origins of the capitalist spirit can be traced to the ethics associated with Puritan sects (the Baptist movement, Calvinism, Methodism, Pietism) and, in particular, to the evolution of doctrine within the Calvinist movement. Capitalism is therefore less the result of the introduction of new technology than the consequence of a new entrepreneurial spirit. Weber (1979) henceforth develops an account of the rise of modern capitalism in post-feudal Europe, emphasizing characteristics broadly similar to those discussed by Marx. The spirit of rational calculation fosters a capitalist economic system in which wage-labourers are legally 'free' to sell their labour power; restrictions on economic exchange in the marketplace are removed; technology is constructed and organized on the basis of rational principles, and there is a clear separation of home and workplace. Furthermore, capitalism enables the consolidation of the legal form of business corporation, the expansion of public credit, organized exchanges for trading in all commodities and the organization of enterprises for the production of commodities rather than simply for trade. Above all, capitalism is characterized by the increased rationalization of social life and the further advance of bureaucratic mechanization (see BUREAUCRACY) is seen as inevitable in the modern world. Capitalism, for Weber, is clearly the most advanced economic system ever created. However, its technical rationality threatens to constrict and extinguish the most distinctive values of Western civilization. Humanity is therefore trapped in an 'iron cage' of its own making:

No one knows who will live in this cage in the future, or whether at the end of this tremendous development entirely new prophets will arise, or there will be a great rebirth of old ideas and ideals, or, if neither, mechanized petrification, embellished with a sort of convulsive self-importance. For the last stage of this cultural development, it

might well be truly said: 'Specialists without spirit, sensualists without heart; this nullity imagines that it has attained a level of civilization never before achieved'.

(Weber, 1930: 182)

While Weber lays stress on the spirit of rational calculation, a second popular approach identifies capitalism simply with the organization of production for markets. This is a usage derived from the HISTORICAL SCHOOL (GERMAN) with its primary distinction between the 'natural economy' of the medieval world and the 'monetary economy' of the modern age. This definition of capitalism as a commercial system is commonly buttressed by an emphasis on a certain type of motive: the profit motive. Thus, in *The Great Transformation*, KARL POLANYI discusses capitalism in the context of the establishment of the market economy, with the 'great transformation' implying a change in the motive of action on the part of the members of society: the motive of subsistence is replaced by that of gain. For Polanyi, the characteristic feature of capitalism is that, for the first time in human history, society is run as an adjunct to the market:

Instead of economy being embedded in social relations, social relations are embedded in the economic system ... [subordinating] ... the substance of society itself to the laws of the market.

(Polanyi, 1944: 57, 71)

Although this definition has affinities with the Sombart/Weber view, its emphasis on the market economy lends it a significantly different focus which has found favour with a number of radical theorists of international political economy (IPE).

Karl Marx sought the essence of capitalism neither in rational calculation nor in production for markets with the desire for gain (a system termed by Marx 'simple commodity production'). For Marx, capitalism is a historically specific MODE OF PRODUCTION, in which capital (in its many forms) is the principal means of production. A mode of production is

not defined by TECHNOLOGY, but refers to the way in which the conditions of production are owned and controlled, and to the social relations between individuals which result from their connection with the process of production. Each mode of production is distinguished by how the dominant class, controlling the conditions of production, ensures the extraction of the surplus from the dominated class (De Ste Croix, 1981: 52). As Marx clarifies in a famous passage, the really distinctive feature of each society is not how the bulk of labour is done, but how the extraction of the surplus from the immediate producer is secured:

The specific economic form in which unpaid surplus labour is pumped out of the direct producers determines the relationship of domination and servitude, as this grows directly out of production itself and reacts back on it in turn as a determinant. On this is based the entire configuration of the economic community arising from the actual relations of production, and hence also its specific political form. It is in each case the direct relationship of the owners of the conditions of production to the immediate producers ... in which we find the innermost secret, the hidden basis of the entire social edifice, and hence also the political form of the relationship of sovereignty and dependence, in short the specific form of state in each case.

(Marx, 1981: chap. 47)

Capitalism is thus perceived as a transient form of class society in which the production of capital predominates, and dominates all other forms of production (generalized commodity production). CAPITAL is not a thing, not simply money or machinery, but money or machinery inserted within a specific set of social relations, based on private property, whose aim is the expansion of value (the accumulation of capital). Capitalism is therefore built on a social relation of struggle between the bourgeoisie and the working class. Its historical prerequisite was the concentration of ownership in the hands of the ruling class and the

consequential and 'bloody' emergence of a property-less class for whom the sale of labour power is their only source of livelihood. The distinction between the sale of labour and the sale of labour-power (the capacity to labour) is crucial, Marx argues, for understanding how all profit derives from the unpaid and therefore exploited labour of the worker. Capitalism therefore combines formal and legal equality in exchange with subordination and **EXPLOITATION** in production. The existence of trade, rational calculation, production for the market, the use of money and the presence of financiers is not enough to constitute a capitalist society. For Marx, capitalism is based on a specific form of private property which enables capital to purchase labour as a commodity and thereby extract surplus value in production. Like Weber, Marx portrayed capitalist society as the most developed historical organization of production. Unlike Weber, Marx thought that **CLASS STRUGGLE** and competition between capitals would intensify, producing ever deeper bouts of crisis, and that at some point capitalism would either degenerate into barbarism or progress to 'socialism'.

All periodizations of capitalism are problematical. While Marx claims that in Western Europe bourgeois society began to evolve in the sixteenth century and was making giant strides towards maturity in the eighteenth century, Polanyi concludes that capitalism did not fully emerge until the Poor Law Reform Act of 1834. The period between the sixteenth and eighteenth centuries is often referred to in IPE literature as the 'merchant capital' phase of capitalism. Industrial capitalism, which Marx dates from the last third of the eighteenth century, finally establishes the domination of the capitalist mode of production:

At first trade is the precondition for the transformation of guild and rural domestic crafts into capitalist businesses. As soon as manufacture becomes somewhat stronger, and still more so large-scale industry, it creates a market for itself and uses its commodities to conquer it. Trade now becomes the servant of industrial produc-

tion, for which the constant expansion of the market is a condition of existence.

(Marx, 1981: chap. 20)

For many analysts, Britain's dominance of the world economy in the mid- to late nineteenth century is seen as constituting the high point of the laissez-faire phase of capitalism. This phase took off in Britain in the 1840s with the repeal of the Corn Laws, the Navigation Acts and the passing of the Banking Act. In line with the teachings of classical **POLITICAL ECONOMY** (**ADAM SMITH** and **DAVID RICARDO**), the state adopted a liberal form which encouraged competition and fostered the development of a 'self-regulating' market society. Liberal and conservative thinkers have been keen to identify this particular phase of capitalism with the essence of capitalism itself. This has encouraged some theorists to dispense with the term completely when describing societies in the post-1945 period. Hence, during the long post-war boom (1950–70), an explosion of terms – industrial society, post-industrial society, welfare statism, post-capitalist society – threatened to displace the centrality of the concept of capitalism. However, waves of economic and political crises experienced in the world economy since this period have led many commentators to reinstate the term. Writers in the Leninist tradition understand twentieth-century developments in terms of the movement from the laissez-faire phase of capitalism to the monopoly stage of capitalism. On the basis of **LENIN**'s famous pamphlet, 'Imperialism: The highest stage of capitalism', the monopoly stage is said to exist when the export of capital alongside the export of commodities becomes of prime importance – banking and industrial capital merge to form **FINANCE CAPITAL**, production and distribution are centralized in huge trusts and **CARTELS**, international monopoly combines of capitalists divide up the world into spheres of interest, and national states seek to defend capitalist interests, thus perpetuating the likelihood of war (see **IMPERIALISM**).

Since the extension of the franchise in nineteenth-century Britain, there has been a

hotly contested debate on the relationship between democracy and capitalism. The experience of the twentieth century, however, shows that there are a variety of political forms – liberal democratic, social democratic, fascist, statist, republican, monarchic – that can accompany capitalist economies. This constitutes the basis for the study of the STATE in capitalism.

From its inception, capitalism has developed in the context of the world market. However, a number of recent changes associated with GLOBALIZATION and the demise of former 'socialist' states have strengthened the claim that capitalism should now be viewed as an integrated, if nevertheless uneven, world system.

See also:

Marxian economics; Marxism- Leninism

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PETER BURNHAM

capitalist crisis

In conventional economic literature, the term 'economic crisis' is avoided and, instead, there are references to DEPRESSIONS – which are viewed as severe recessions.

A 'capitalist crisis' can be defined as a sudden increase in unsatisfied needs that occurs at the same time as decreases in employment and in utilization of the means of production. The population becomes more impoverished because CAPITALISM is less efficient in using the economic resources, not because of a lack of them. For example, in the Republic of Korea, domestic car sales in July 1998 were 58.4 per cent less than in the same month in 1997. But this did not happen because consumers needed less cars but rather because an economic crisis had been devouring the country since the end of 1997. Many workers had lost their jobs and the inactive capacity of nearly all the industries in Korea and in many other Asian countries elevated dramatically – even though for decades these countries had been among those with the highest growth rates.

Economic crises have been repeating themselves for several centuries now, and with many of the same features: businesses in bankruptcy, increasing unemployment, generalized drops in production and sales, increasing numbers of insolvent debtors, CAPITAL FLIGHT to other countries and so on. Some characteristics of the crises have changed, however: previously, prices tended to rise during a boom and fall during a crisis. For example, between 1929 and 1932 the prices of US products fell by nearly 20 per cent. This would currently be unimaginable, since moderate or galloping INFLATION is a characteristic of today's capitalism. Unlike in the past, inflation rates now drop during crises but not prices.

Material losses caused by capitalist crises are frequently greater than those resulting from hurricanes or earthquakes; this is due to the intensity of crises and the scope of their impact. In pre-capitalist societies, economic crises occurred when natural disasters or certain social catastrophes (such as WAR) destroyed

the means for living. Today, as in the pre-capitalist stages of human history, economic crises caused by nature affect social classes unequally, frequently hitting workers the hardest. For this reason, we cannot speak strictly of natural economic crises, since all crises are modulated by the characteristics of the societies in which they are experienced. Because of their effects, capitalist economic crises can appear similar to previous crises, but the difference is that capitalist crises are produced by the very structure of society and therefore, when the crises are intense, they seem to question the very capitalist order.

Increased unemployment and thus the impoverishment of wage earners are – together with failed businesses – among the most characteristic symptoms of crises. Frequently, a drop in real production is accompanied or preceded by financial upheavals, such as the collapse of financial institutions, devaluation and capital flight. For example, on 13 December 1998, the Japanese government had to take control of the Nippon Credit Bank because it considered the institution – one of the fifty largest banks in the world – to be insolvent. It is estimated that during the 1980–96 period, the banking sector in two-thirds of the member-countries of the INTERNATIONAL MONETARY FUND (IMF) had serious problems that were causing major losses. One of the worst cases was in Spain, with a loss of approximately 17 per cent of the GROSS DOMESTIC PRODUCT (GDP) during the bank crises extending from 1977 to 1985. The connections between financial phenomena and those of the real economy are complex. For example, in 1974–5, a generalized international crisis took place and the United States had its worst crisis of the thirty years since the end of World War II. US stock exchanges experienced serious drops: the annual average for the Standard & Poor composite index fell by 23 per cent from 1973 to 1974, but the drop was not preceded by an excessive rise in shares value. To the contrary, the Japanese crisis that extended across nearly the entire decade of the 1990s, began with a speculative boom which drove the Nikkei index from a value of 12,000

in 1986 to 39,000 in 1989, and land prices rose so high that Japan's territorial property was valued four times higher than that of the United States. In the case of the US crisis of 1974–5, the problems in stock exchanges could have been derived from difficulties in the real economy, but the contrary seems to have taken place in Japan during the 1990s.

There have been serious disagreements among economists over the causes of crises and their mechanisms of transmission, and also over what must be done to avoid them or at least diminish their most destructive effects. JOHN MAYNARD KEYNES, F.A. VON HAYEK and ROSA LUXEMBURG personify the disagreements among economists over why crises occur and what to do about them. Keynes believed combating crises was possible and necessary; Hayek, however, labelled Keynesian aspirations to control crises absurd; Luxemburg saw in economic crises the objective need to change the capitalist system. At the end of the 1960s, Keynes reigned from his tomb, since crises were viewed as inoffensive and policies for stimulating demand were implemented across the entire capitalist world. Later, economists began to refer to such policies as absurd and even counterproductive in terms of stabilizing economies, just as Hayek had proclaimed. The divergence of opinions regarding what to do in the face of crises can be seen in the current application of pro-cyclical measures (such as cutbacks in public spending) in some countries (Brazil in 1999) and, at the same time, anti-cyclical measures in other countries (Japan in 1999). It remains to be seen if economic crises are being kept under control, as some economists affirm, or if it is urgent for societies to implement a deep economic transformation, as maintained by critics of capitalism.

See also:

business cycles; Great Depression; poverty

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ALEJANDRO VALLE BAEZA

Caribbean Community (CARICOM)

The Caribbean Community (CARICOM) was formed in 1973, encompassing thirteen countries: Antigua, Barbados, Belize, Dominica, Grenada, Guyana, Jamaica, Montserrat, St Kitts-Nevis, St Lucia, St Vincent and the Grenadines, Trinidad and Tobago, and the Bahamas (Suriname also joined in 1995 as the first non-English-speaking member). Its purpose is to promote economic development by liberalizing trade and erecting a common external tariff (CET). After nearly twenty years of negotiations, the CET began a six-year phase-in period in 1992 that has proved difficult to implement. CARICOM offers its poorest members generous preferential treatment, allowing various practices to protect trade.

WILLIAM P. AVERY

Carr, E(dward) H(allett) (1892–1982)

E.H. Carr is frequently listed as one of the most influential political realists of the mid-twentieth century. After twenty years in the British foreign service, in which he witnessed the post-1918 peace negotiations and the League of Nations firsthand, Carr went to the University of Aberystwyth in 1936 as Woodrow Wilson Professor of International Relations. It was in this capacity that he wrote several books on international relations (IR), of which the most enduring has been *The Twenty Years' Crisis*, first published just after

the outbreak of war in 1939. However it was through the leader columns of *The Times*, where he served as deputy editor from 1940–7, that Carr had the greatest influence on public opinion, consistently showing greater concern for and understanding of economic issues than most political commentators of his day.

Carr's statement of British priorities in the summer of 1940 gave equal salience to the achievement of full employment and defeat of the Axis Powers. His analysis of the obsolescence of small NATION-STATES placed as much emphasis on the effects of inter-war world DEPRESSION on small trading nations as on mechanized armour and the long-range bomber. His chief conclusion was that the post-war world was bound to witness extensive state control of the economy and the progressive incorporation of small states into the kinds of larger political groupings that alone would prove strategically and economically viable in future. Notoriously, these considerations led Carr to condemn the fragmentation of East and Central Europe embodied in the Treaty of Versailles and to sympathize with German revanchism in the 1930s. Just as notorious was his entirely consistent support in the 1940s for Soviet HEGEMONY in the same region. Less often mentioned are his support for British participation in western European INTEGRATION, his admiration for the self-governing British Commonwealth and his relaxed attitude to the power of the United States in the Western hemisphere.

The chief elements in Carr's work of theoretical relevance to the student of international political economy (IPE) must be his attack on LAISSEZ-FAIRE liberalism and his treatment of POWER, both of which found mature expression in *The Twenty Years' Crisis*. Carr regarded FREE TRADE as the ideology of satisfied or status quo countries such as Britain and France. At the Ministry of Information in the early months of the war he went further, arguing that Britain must adopt a more *dirigiste* stance if it were to win the propaganda battle against Hitler's New Order. This position was spelt out in more detail in his *Times* editorials of the summer of 1940 and in

Cartagena Declaration on Refugees

Conditions of Peace (1942), which argued on both humanitarian and realist grounds for the creation of a WELFARE STATE.

Methodologically, Carr has continued to command attention for his resolutely anti-positivist and social constructivist stance, for his clear analytical distinction between political power, economic power and power over opinion, and in consequence for the informed and extensive consideration that he gave to international economic relations. Carr made clear how unevenly the gains from a liberal world economy were distributed and how reliant it had always been on the force of British arms. In doing so he justified the protectionism and military assertiveness of revisionist powers like Germany or Japan. Yet this attention to economic power was always qualified by a final emphasis on the STATE, which Carr believed would progressively become paramount over information and the economy. Much of his appeal to those who originated academic IPE in the 1970s lay in Carr's very calculatedly non-provocative statement of a broadly Keynesian position (see KEYNESIAN ECONOMICS). Originally designed to win over British conservatives in the 1940s, Carr's rhetoric was later to provide a robust rearguard against the advancing tide of NEO-LIBERALISM.

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CHARLES JONES

Cartagena Declaration on Refugees

The Cartagena Declaration was adopted in 1984 at the end of a meeting of experts and government officials from various Latin American countries which took place in Colombia. In spite of its legally non-binding nature, this declaration has played an important role in promoting the advancement of refugee law in Latin American countries. The declaration also recommended that the definition of the term 'REFUGEE' be enlarged following the example of the 1969 ORGANIZATION OF AFRICAN UNITY (OAU) CONVENTION ON REFUGEES.

See also:

Convention on Refugees; migration, international

Further reading

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GUGLIELMO VERDIRAME

cartelization

Cartelization is the organization of a cartel (see CARTELS) by nominally independent producers. It refers to the process of forming a cartel, as well as to the means of this formation. When scholars study cartelization, they are generally attempting to understand the conditions under which cartels form and are sustained over time. In international political economy (IPE), the process of cartelization is also occasionally treated as an analogy for cooperation more broadly: by examining how competing producers establish cartels, scholars hope to explain

how competing states can forge their own versions of COOPERATION.

In their most basic form, cartels are simply cooperative arrangements entered into by a group of producers who seek, collectively, to receive higher profits from their sales by agreeing, individually, to limit the quantity that each sells. Definitionally, cartels can only arise out of OLIGOPOLY; in a monopolistic market there is no need for collusion between producers and in a fully competitive market there are too many producers to make co-operation between them possible.

The formation of a cartel indicates that the normal forces of competition have been stalled. Yet, at the same time, the possibility of a cartel is inherent in the very structure of a competitive oligopoly. Because all markets operate on the premise that each producer will seek to maximize its own profits, producers in an oligopolistic market will eventually realize the profit-making opportunities of collusion. If the producers succeed in their collaboration, however, the result of their efforts will be distinctly non-competitive, since the very aim of this collaboration is to increase the profits of the group by restricting output and pushing prices above what an uncontrolled market would warrant. Thus cartelization is simultaneously a response to competition and a cessation of it.

Wherever it occurs, cartelization essentially entails the same basic process and tension. Competing producers must each agree to subordinate their individual drive for profits to the greater economic interest of the entire group. Yet the empirical record of cartels demonstrates that the success of cartelization efforts varies widely. Despite the logic that would seem to compel them, cartels remain a fairly elusive phenomenon of the international economy. How, then, can we understand the forces that permit or prohibit cartelization? How can we distinguish the few that have succeeded from the mass that have failed?

Typically, economists have argued that structural factors are the most important determinants of cartelization. In particular, they suggest that cartels are most likely to arise in markets characterized by five specific

factors: a high concentration of production, a small number of fringe (or outside) producers, high barriers to entry, non-substitutability and non-differentiation. The reasoning behind these determinants is straightforward. For instance, a high concentration of production implies that the basic problem of collective action has been alleviated: the fewer producers there are in a market, the easier it will be for them to form a joint endeavour. Likewise, a small fringe reduces the possibility that producers outside the arrangement will be able to impede cartelization by reducing their own profits. High barriers to entry lessen the likelihood that new entrants to the market will be able to disrupt the cartel and non-substitutability reduces the risk that consumers will simply refuse to buy the product at elevated prices. Finally, non-differentiation means that the producers can not engage in non-price competition while still maintaining non-competitively high prices.

Without denying the importance of these structural factors, other scholars have argued that internal factors also play a critical role in the process of cartelization. Certain kinds of producers, they suggest, will be more successful at creating and maintaining cooperation than others. Specifically, the successful producers will be those whose internal organization and culture allow them to implement the tasks of the cartel. That is, they will be those producers who are able to distribute the gains of cooperation, punish defectors and bear the costs imposed by restricting output. They will be producers with sufficient internal authority to make binding decisions and to force other members of their organizations to bear the occasional costs of these decisions. Most likely, they will be producers whose power is not subject to internal dissension, producers who can make external commitments without fear of defection from among their own ranks. Cartelization, in this view, is best undertaken by strong producers willing to engage in strong-arm tactics. It is further facilitated when producers have sufficient resources to absorb the costs of cooperation and a time-horizon

cartels

long enough to make them willing to accept these costs.

These two views of cartelization suggest different approaches to theory and to policy-making. Under the structural view, cartels and cooperation can best be understood by examining the structure of the market in which firms compete or the structure of the system in which states interact. To prevent cartels from forming, or to prod states towards cooperation, structural solutions must be sought. By contrast, the internal view suggests that structure is less important than internal characteristics. The sources of cartelization and cooperation both lie in the nature of the actors concerned.

See also:

competition and government policy; competition between local and foreign industries; competition between states; structuralism

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tural variables that can either constrain or impede the process of cartelization.

DEBORA L. SPAR

cartels

Cartels are cooperative agreements between producers in the same industry who would otherwise be expected to compete with one another. By banding together, these producers seek to limit the effect of market forces and instead to manage output and prices to maximize their own individual profits. The presumed result of this collective effort is a lower supply of the cartelized product and thus a higher market price. Accordingly, economists and policy-makers generally regard cartels as anti-competitive and contrary to the best interests of consumers in a free market. Most industrialized nations either prohibit cartels or restrict the possible scope of their operation.

Occasionally, though, nations have chosen to champion cartels as a means for stabilizing markets or protecting infant industries (see INFANT-INDUSTRY PROTECTION). Cartels were a dominant feature of Germany's economy in the late nineteenth and early twentieth centuries and remained prevalent in Japan even after World War II. Supporters of cartels in these cases have argued that they smooth the edges of the market economy, protecting growing nations from the dangers of excessive or 'ruinous' competition.

Where cartels are not supported by government initiatives, they typically prove difficult to maintain. Theoretically, a cartel is in the interests of all members: by raising the price of the cartelized product, the cartel enhances the profits of the producers. Yet any individual member always has an incentive to defect from the agreement, lowering their price to grab a larger share of the total market. Private cartels, therefore, tend to be short-lived and exceedingly fragile.

See also:

cartelization: cartels

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DEBORA L. SPAR

cartels, commodity

Commodity cartels are cooperative agreements struck by the producers of a particular commodity. Like CARTELS in general, they represent an attempt by the producers to control the market for their own product, and to direct the supply and price of that product to serve their own financial interest.

As the name suggests, commodity cartels are cartels that seek to control COMMODITIES, products which are generally regarded as being interchangeable. Agricultural goods, such as coffee, bananas or sugar, are nearly always regarded as commodities; so are minerals, such as copper or tin, and other extracted resources, such as oil and gas. What distinguishes commodities from other goods is the relative inability of these producers to differentiate their product through means such as quality improvements or advertisement: all copper is essentially the same. Thus competition in commodity markets is particularly subject to the economic vicissitudes of supply and demand.

This configuration makes commodity markets ripe for CARTELIZATION, since increasing the supply of any commodity will generally

serve only to reduce the price that all producers of the commodity will be able to charge. But if the producers can cooperate to reduce their output and prevent excess supply from reaching the market, then all can share the benefits of higher prices. This is the prize that commodity cartels appear to offer to the producers that choose to form them. In many cases, cartelization also holds out the prospect of stabilizing what might otherwise be naturally volatile markets. This is especially true for agricultural commodities, where fluctuating seasons and weather patterns can lead to wide swings in supply.

Historically, commodity cartels have often been wielded as instruments of either political or economic power. By the early 1970s, for example, proponents of international commodity cartels in the developing world were infused with a palpable enthusiasm, while those who feared the political ramifications of these cartels were warning of impending disaster. The ORGANIZATION OF PETROLEUM EXPORTING COUNTRIES (OPEC) was threatening to use its 'oil weapon' to sway the foreign policies of the industrialized states, and the producers of dozens of other commodity products were eager to form their own arrangements and exert their own nascent power. Buoyed up with this optimism, DEVELOPING COUNTRIES supported and strengthened the UNITED NATIONS CONFERENCE ON TRADE AND DEVELOPMENT (UNCTAD) – a permanent international organization designed to foster and facilitate a wide range of international COMMODITY AGREEMENTS.

By the mid-1980s, however, most of these commodity cartels had either collapsed or slipped into an effective lethargy, as their members continually proved unable to control their markets or even to avoid the temptations of defection. OPEC remained a force in the world economy but, lacking internal discipline, it did not succeed for long in deploying its political weapon or even in holding oil prices above normal levels. One of the few enduring cartels has been in the diamond market, where the DeBeers Corporation retains a legendary

control over the world's supply and price of gem diamonds.

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DEBORA L. SPAR

Cartesian economics

The ideas of the French philosopher René Descartes (1596-1650) had a major influence on the methodology of economics, exemplified by the dominant mode of formal theorizing. In fact, the majority of contemporary economics

exhibits a Cartesian type of thought. According to Descartes, sensual observations are not to be trusted. That 'Cartesian doubt' leads to the thesis that mind and matter are to be separated in order to gain insights into the universal laws of nature. The spheres of nature and human thought constitute two distinct areas, with a supremacy of mind over matter. Consequently, the Cartesian position maintains that the axiomatic logic of abstract reasoning, as represented by mathematics, is an indispensable point of departure for further theorizing because it is essentially superior to statements that are based on empirical observation and experience only.

This corresponds with the mechanistic and atomistic dimensions of the Cartesian methodology of science. Descartes suggested that problems under consideration should be deconstructed to their most fundamental, irreducible elements, as insights regarding these isolated units would provide the necessary knowledge for explaining the complete problem. An organicist world-view, with its inherent HOLISM, was thus rejected in favour of a mechanistic notion of economic and social life, accompanied by a conceptual ATOMISM.

Most of the constitutive features of NEO-CLASSICAL ECONOMICS may be derived from the impact of that Cartesian philosophy: for example, the methodology of abstraction, the emphasis on the measurability of categories like utility, as well as the corresponding assumption of individual rationality. In fact, traditional strands of neo-classical economics like GENERAL EQUILIBRIUM theory and WELFARE ECONOMICS, with their distinct concepts of resource allocation and income distribution, are based on Cartesian notions of rationality.

On methodological grounds, the Cartesian influence has found an appropriate expression in terms of methodological individualism (see INDIVIDUALISM, METHODOLOGICAL), as well as the notion of the rational *homo oeconomicus*. Neo-classical economists have expanded that idea to the theory of the profit-maximizing firm, which may be tested empirically but which is not stylized according to empirically valid experience. While major economists like

J.M. KEYNES and J.A. SCHUMPETER criticized that kind of unconditional application of Cartesian ideas, it seems that the decline of mechanistic and atomistic notions in economics is accelerated by a current paradigm change in the natural sciences. Therefore the dominance of the neo-classical approach as a Cartesian economics is currently challenged by EVOLUTIONARY ECONOMICS.

See also:

institutionalism; post-rationalist international political economy; rationalist conception of action; realism

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ALEXANDER EBNER

casino capitalism

'The Western financial system is rapidly coming to resemble nothing as much as a vast casino', commented SUSAN STRANGE in the first sentence of *Casino Capitalism*, her 1986 book on the political economy of global finance. Strange highlights the dramatic difference between the staid and sober image that used to be associated with finance and the high-stakes gambling that characterizes con-

temporary finance. She notes a number of serious consequences of this change. All of us, whether we want to be or not, are affected as our jobs, businesses and pensions can be put at risk by the gyrations of exchange rates and interest rates. The prevalence of luck undermines commitment to hard work, initiative, ethical conduct, and to the social and political system more generally, particularly as the negative consequences of financial GLOBALIZATION are unequally distributed across the world's population. Increased uncertainty can spill over into the relations between states.

One of Strange's distinctive contributions was to highlight the role played by governments in bringing about the globalization of finance, challenging the familiar view that sees globalized markets as counterposed to and triumphing over states. She stresses that these changes involved numerous points at which governments decided to act or not to act, from more distant 'non-decisions' (such as the failure in the 1950s to construct any system for handling bad international debts) to more direct decisions (such as leaving the markets alone and not constructing a new regulatory regime in the 1970s). She stresses the pre-eminence of the United States in this process, and sees its acceptance of responsibility for regulating its domestic financial system and international banking more generally as the most viable way to regain control over the casino.

See also:

Bretton Woods system; eurocurrency market; euromarkets; foreign exchange; liberalization

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TONY PORTER

Central African Customs and Economic Union (CACEU)

The Central African Customs and Economic Union (CACEU), or Union Douanière et Economique de l'Afrique Centrale (UDEAC), was established in 1966. It is the successor to the Equatorial Customs Union (ECU), or Union Douanière Equatoriale (UDE), which was established in 1959 by the four former French colonies Gabon, the Central African Republic, Congo and Chad, with Cameroon joining in 1960. In 1968, the CACEU was divided when the Central African Republic and Chad joined Congo-Léopoldville (Zaire) in another union. In 1983, the Republic of Equatorial Guinea also became a member of the CUSTOMS UNION (CU), one year before Chad renewed its membership.

J.E.C. ENGELBERTS

Central American Common Market (CACM)

The Central American Common Market (CACM) was created in 1960 as a CUSTOMS UNION (CU), with plans ultimately to become a COMMON MARKET. Significant progress has been made towards liberalizing trade and implementing common external tariffs (CETs). Intra-regional trade in agriculture, for example, is almost completely free of tariffs and most members have adopted CETs ranging from 5 to 20 per cent. Member-countries are Costa Rica, El Salvador, Guatemala, Honduras and Nicaragua. Panama and Belize do not participate directly in the trade regime. With an average per capita GROSS DOMESTIC PRODUCT (GDP) of less than US\$1,900 per year, it is one of the poorest trading blocs in the hemisphere.

WILLIAM P. AVERY

central bank independence

Independent central banks are those which have a high degree of autonomy from government interference in carrying out domestic monetary policy (see MONETARY POLICIES). Highly independent banks have autonomy from their governments in formulating and carrying out policy with respect to the official discount rate (the rate at which the central bank lends to other financial institutions), open market operations (the purchase or sale of SECURITIES – usually short-term government treasury bills – made to influence the money supply) and minimum reserve requirements (the portion of their deposits that banks and savings institutions are required to hold in legal reserve). 'Independence' means that the central bank has the ability to use these instruments of monetary control without instruction, guidance or interference from government. Central bank independence has become central to the study of political economy because of the effects that such independence is argued to have on macro-economic conditions. Controversy exists, however, regarding how to conceptualize and measure independence, the exact conditions under which independence can be expected to influence macro-economic conditions, and how to explain central bank independence itself.

Measures of central bank independence

One of the central issues in the literature on central bank independence is how to measure it. Quantitative studies have attempted to develop a set of simplified indicators of independence that can be generalized across a large number of cases and over time. One approach has been to distinguish *de jure* from *de facto* measures of independence. *De jure* measures reflect the legal relationship between the central bank and its government. Indicators include statutory length of term in office of the governor; proportion of central bank policy board-members appointed by the government;

formal shared decision-making mechanisms; mechanisms for resolving bank-executive branch conflicts, reporting requirements or oversights; requirements that the bank finance government budget deficits, and the extent of the constitutional guarantee of the bank's independent status. One serious shortcoming of most *de jure* measures of central bank independence is the fact that legal independence may not reflect the degree of autonomy the institution has in practice. *De facto* measures, on the other hand, attempt to gauge an institution's independence as revealed through behavioural indicators. One approach has been to look at the actual average turnover of the bank's chief executive officer. This approach suffers from the problem that a long tenure in office could mean either high independence or implicit political control, since the governors might alter policy in order to maintain their jobs. Another *de facto* measure involves calculating how actual central bank policy differs from that which might be predicted by 'economic fundamentals' – an approach that requires strong assumptions about just what policy such fundamentals require.

Another way to conceptualize central bank independence has been to distinguish goal independence from instrument independence (Fisher, 1994). The former captures the bank's ability to set its own targets independently and the latter reflects the bank's ability to choose which instruments to employ to achieve a given target. With respect to goal independence, for example, the objectives of the BUNDESBANK are not very precisely specified, giving it a great deal of autonomy in this regard. The FEDERAL RESERVE, on the other hand, is required to aim for the multiple objectives of price stability and full employment, which can be thought of as diluting its 'conservatism' and goal independence.

While there is a general consensus that the German Bundesbank by virtually all measures represents one of the most independent monetary authorities in the world, there is somewhat less consensus on how other major countries ought to be ranked. Using goal independence

as a measure, the most independent central banks are those of Germany and Switzerland, followed by the Netherlands, Japan and the United States. The least independent among major ORGANISATION FOR ECONOMIC CO-OPERATION AND DEVELOPMENT (OECD) countries by this measure was the United Kingdom (Fisher, 1994) prior to Chancellor Brown's reform of monetary policy-making in 1997. However, a number of other analysts rate the Bank of Japan as much more politically constrained (Grilli, Masciandaro and Tabellini, 1994). This impression is sustained by those who have made more in-depth case studies (Henning, 1994). Indeed, in the judgement of those who have conducted careful case studies, it is usually impossible to reduce central bank independence to a small set of indicators without understanding the political and institutional context. In the Netherlands, for example, the requirement that a governmental decision to override the judgement of the central bank must be approved by the legislature actually imparts a great deal of independence to the monetary authority. The strength of this arrangement, however, depends very much on current legislative political configurations.

The fact that the broader context of many indicators of independence take on varying significance in different political and institutional contexts is widely recognized, but complicates and qualifies simple portrayals of central bank autonomy. For example, the importance of a requirement that the central bank finances a government's deficit depends on the fiscal profligacy of the government concerned; the importance of the length of the term in office depends on the scope of the governor's powers and the continuity of party control in government. Banks that appear independent on paper may in fact be subject to a strong degree of political influence.

The effects of central bank independence

Centring responsibility for monetary policy within politically independent, technocratically oriented institutions is thought to remove

monetary policy from government incompetence and from electoral or partisan manipulation. The need to separate monetary policy-making from political control is primarily justified in terms of controlling inflation. The starting point for many analyses is that monetary policy-making involves a 'time inconsistency' problem, in which it may be rational for governments to announce stringent monetary policies, but to implement rather more stimulatory policies (assuming governments would rather preside over a growing than a stagnant economy). But unless the monetary authority can be credibly bound to restrictive monetary policies in the future, private actors will renegotiate wage and price contracts, thus undercutting growth and perpetuating inflation. Independent central banks have been viewed by many as one way to bolster the credibility of the monetary authority to pursue a consistent low-inflation policy.

Several studies have found evidence that highly independent banks are associated with lower levels of inflation for the most developed industrial economies (Alesina and Summers, 1993; Cukierman, Webb and Neyapti, 1992). It has been more difficult to establish the effects of central bank independence on the real economy. Cukierman and his colleagues find a relationship between independence and higher growth rates, higher levels of investment and lower variability in real interest rates, but other studies have been unable to discern a relationship between central bank independence and growth and employment (Alesina and Summers, 1993). One study has shown that central bank independence was positively associated with current account strength and capital inflows during the inter-war years (Simmons, 1994). In developing countries, the macro-economic consequences prove to be highly sensitive to the way in which one defines independence (discussed in more detail below): legal measures of independence do not seem to contribute to price stability, but more behavioural indicators (such as governor turnover) do.

On the other hand, three arguments have been raised against highly independent central banks. First, it has been argued that they may

make it more difficult to coordinate policy with fiscal authorities within countries: a highly independent monetary authority can lead to 'over-steering' of the economy because the fiscal policy authorities may try to compensate for policies of the monetary authority and vice-versa. Second, independent central banks may make it more difficult to effect external adjustment in fixed exchange rate regimes, since their emphasis on domestic price stability can at times force deflationary adjustments onto trading partners who otherwise would be forced to exit the exchange rate regime (Simmons, 1996). Finally, highly independent central banks may lead to problems in democratic accountability. The more independent the monetary authority from government, the more tenuous is the voter's ability to influence the economic policy-making process, and the more the polity is likely to have to endure a policy that is much more anti-inflationary than the policy the voters would prefer.

Increasingly, it has been argued that independent central banks may have interactive effects with other institutions, such as labour markets and collective bargaining mechanisms: for example, a number of political scientists have argued that central bank independence leads to lower inflation, lower unemployment and higher growth only when accompanied by highly centralized institutions for collective bargaining (Hall, 1994). These studies suggest that the economic effects of monetary authority independence must be understood within a broader institutional perspective.

Explaining central bank independence

A final focus of research has been to explain the variance in central bank independence across time and space. While institutions such as the Bank of England have enjoyed highly independent status for much of their long history, several monetary authorities lost a degree of their autonomy during the 1930s (for example, the Bank of France) or after World War II (the Bank of England). However, between 1990 and 1995, many more countries than at any time in the post-World War II era

have considered legislation to establish or increase the independence of their monetary authority (Maxfield, 1997). The political and economic conditions that provide the incentives for establishing or redesigning independent monetary institutions has been explained largely in terms of the political need for monetary credibility under changing circumstances.

One such condition is the government's need for finance. Accounts of the establishment of the Bank of England have emphasized the government's need for financial resources in order to prosecute its wars with France as being crucial to the bargain to delegate authority to the central bank. By delegating authority to an independent monetary institution, this argument goes, governments are better able to credibly commit themselves to stringent policies, the effect of which is to reduce interest charges on new government debt (North and Weingast, 1989).

A second cluster of research suggests that central bank independence is much more likely in countries that have highly developed financial sectors. As some research suggests, this could be due to the fact that the financial sector is an active constituency for stable prices and hence for an independent monetary authority (Woolley, 1985; Goodman, 1992; Maxfield, 1990). Goodman, for example, shows that in 1981 central bank independence was a high policy priority of private financiers, who succeeded in part because of labour's quiescence on the issue.

Another strand of research has concentrated on explanations related to regime type or the nature of the party system or ideology. Some studies suggest that increased political competition enhances the prospects for central bank independence, perhaps as an institutional solution to potential policy instability or uncertainty. There is no consensus, however, on how differing partisan ideologies or policy preferences influence the likelihood of independence. Cukierman (1992) argues that party polarization increases the likelihood of central bank independence in democracies, which might be interpreted as a rational response to

a potentially inflationary political situation. However, other scholars have argued that in two-party systems central bank independence is more likely under 'catch-all parties' which compete for the broad political centre, since such party systems allow the executive a great degree of policy leeway (Bernhard, 1995). According to this conception, a central bank that is independent from the executive but reports to the legislature is viewed as a way to check the power of the government.

Finally, evidence suggests that central bank independence is encouraged by the need to attract highly liquid foreign capital (Maxfield, 1997). In this understanding, politicians use central bank independence to try to signal their credit-worthiness and commitment to 'responsible' macro-economic policies to would-be creditors both at home and globally. The more liberal the regime of capital controls, the more important this credibility role for independent central banks is likely to be.

See also:

financial regulation

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BETH SIMMONS

CENTRALLY PLANNED ECONOMIES

see command economies

chaebol

The word *chaebol* refers to business groups or business conglomerates in South Korea. Its meaning is identical to the Japanese term *zaibatsu*. Several unique features characterize its governance structure: a high degree of ownership concentration in the hands of a single family, an extremely vertical control of corporate management, very high debt equity ratios, and organic networks between its affiliates through cross-ownership, cross-investments, cross-payment guarantees and central coordination. *Chaebol* have become the primary source of economic concentration in South Korea. In 1995, the top thirty *chaebol*'s value-added output accounted for 16.9 per cent of the GROSS NATIONAL PRODUCT (GNP). Business concentration is another key feature of Korean *chaebol*. The thirty top *chaebol* owned an average of nineteen affiliates in 1996, engaging in diverse business activities ranging from manufacturing of cars, ships and airplanes, to owning and managing restaurants. Market concentration is its other distinctive character. In 1996, of 138 firms which were under the government's watch list of monopolistic or oligopolistic practices, 89 came from affiliates of the *chaebol*. The top thirty *chaebol*

also accounted for 89.2 per cent of total sales in the manufacturing sector in 1995.

The rise of the current *chaebol* system can be attributed to the heavy-chemical industrialization strategy of the 1970s. During the big push period, the South Korean government heavily utilized selected business groups as agents of economic growth and industrialization, and extended various incentives to them, such as preferential allocation of financial resources, market protection, and permission to establish monopolies and oligopolies (see MONOPOLY; OLIGOPOLY) in order for them to benefit from ECONOMIES OF SCALE. The *chaebol* can thus be seen as a product of the South Korean government's industrial policy. In return, they became a major base of political support for the government, resulting in the formation of a hegemonic coalition that dictated the nature and direction of economic development. Thus the rise and expansion of the *chaebol* is closely associated with the dynamics of political business connections (*junghkyung yuchuk*).

The *chaebol* made a significant contribution to fostering EXPORT-LED GROWTH in South Korea, but they were equally responsible for negative externalities such as income and wealth inequality, uneven sectoral development, structural corruption and the hollowing-out of small- and medium-sized firms. More recently, the *chaebol* have been heavily criticized for their reckless corporate expansion through external borrowing, despite faltering profits and bankruptcies, and the proliferation of non-performing loans from them were known to be the direct and immediate causes of the economic crisis, making INTERNATIONAL MONETARY FUND (IMF) economic trusteeship necessary since late 1997. In the wake of the crisis, however, the landscape of the Korean *chaebol* is undergoing profound changes. Of the thirty top *chaebol*, only the top five remained intact, while the others either went bankrupt or have been fundamentally downsized or consolidated. Even the top five *chaebol* (Hyundai, Samsung, Daewoo, LG and SK) have been subject to major corporate restructuring and downsizing under the government's 'big deal' measures. The *chaebol* will

continue to be the dominant actors in the South Korean economy, however, but their power and influence will be significantly curtailed.

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CHUNG-IN MOON

change

Change, semantically the shift from one condition to another, has been understood in diverse ways by students of international relations (IR). A variety of research programmes underlies this diversity of understandings. One can distinguish (at least) five different analytic foci, each with a different conceptualization of 'change'.

First, in its most elementary meaning, change can refer to the transformation of one single condition or state to another. A given data-point or a given indicator can change in value. This is largely an observational issue, although such observations are not, of course, devoid of a theoretical basis. That is, while we might have theoretical motives that make us more interested in particular events or statistics, in and of themselves the observations need not be explained by a larger theoretical edifice. For example, we might examine changes in the average GROSS NATIONAL PRODUCT (GNP) per capita, but in and of itself the observation does not require a clarification of the meaning of that statement.

Second, change can mean the transformation of linked phenomena into another configuration. Thus one can study the transformation

from FEUDALISM to CAPITALISM. These phenomena are not merely linked in a purely empirical manner which is readily accessible to the observer, but they are logically grouped together through a deliberate theoretical exercise on the part of the subject. This process thus involves more than simply observing changes in data-points, but requires an elaboration of causal connections between such data and a clarification of how alterations in fundamental causes have led to a new constellation which is logically interrelated. For example, the study of the feudal-capitalist transformation requires the specification of how disparate empirical phenomena – serfdom, vassalage, exchange in kind, military service – are interconnected, and how such a system may be displaced by other phenomena, which are similarly linked in a complex architecture. Marxist and neo-Marxist theories (see MARXISM–LENINISM; NEO-MARXISM), and historical sociology, are examples of such endeavours to explain macro-level phenomena.

Third, change can refer to the nature of sequentiality. How are the grouped observations related to a prior set of data? In some scientific endeavours, the causes of change might be almost completely exogenous. External shocks underlie the shift from one set of conditions to another, and the two sets of conditions are not logically interrelated. For example, cataclysmic events (punctuation events) might affect the ability of one species to survive rather than another. Neither the cataclysmic event nor the set of observations that will subsequently prevail (in the equilibrium phase) are *a priori* predictable. Few theories in the social sciences follow such a model, although the punctuated equilibrium model of biology has gained in the social sciences as well, largely as a metaphor to explain dramatic and sudden institutional change. Instead, many theories of social change are based on a linear view of continuity or discontinuity. Event *y* (or sets of events grouped and defined as *y*) follows logically from the prior event *x* (or sets of events grouped as *x*). According to the Marxist view of history, the prior stage contains the seeds of

its own demise, thus inevitably leading to a successive stage. A prior state may also be linked to the observed state through a cyclical view of social and political events. Cycle theory, such as the theory behind KONDRATIEFF WAVES, submits that events cluster around an equilibrium. Oscillation from that equilibrium (say through economic expansion) will inevitably lead to a compensating move back to that equilibrium (hence, one will expect to observe economic contraction). Some long-cycle theorists have taken such views to explain state contraction and expansion by a logic of increasing or decreasing rates of return from territorial expansion.

Fourth, students of change can also refer to the pace of change in which events modulate. FERNAND BRAUDEL thus distinguished the pace of everyday events as being rapid and in continuous flux. At an intermediate level, the socio-political level, events could be measured in decades. For example, the transformation from authoritarianism to democracy, or the vicissitudes of economic cycles, were characterized by longer temporal dynamics than everyday politics. At the deep structural level, the *longue durée*, events are presumed to be embedded in an even larger contextual framework which changes extremely slowly and might last for centuries. Thus, in Braudel's view, one could analyse the everyday decisions of political and economic elites. But such decisions occurred against the backdrop of deeper structures: the condition of the economy or the nature of the regime. All this operated against an even longer periodization, in which the level of technology and existing trade routes were the critical variables.

Finally, there has been a debate in the IR literature about whether the nature of the international system, and consequently the behaviours of actors in that system, are subject to historical change. On one hand, neo-realists like Kenneth Waltz argue that the behaviour of individual actors has remained constant (see NEO-REALISM). Given international anarchy, states have behaved remarkably similarly. But even within the neo-realist paradigm, some (such as ROBERT GILPIN) suggest that funda-

mental changes can take place in the international system, through which the transformation of one unit type to the other (say the change from empires to states) has profound effects on behaviour. STRUCTURATION theorists take such arguments even further, submitting that the international system and structure are constantly being reshaped by actors' interpretations and their subsequent behaviours, but that the agents of the system (states) are also constantly affected by changes in the overall milieu. Additionally, some scholars have started to examine how changes in the level of global transactions and communications affect the current system of states.

See also:

change, progressive; change, regressive; structural change; technological change

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HENDRIK SPRUYT

change, progressive

The concept of progressive change emerges with the European Renaissance, replacing the cyclical concepts of change which had held sway for millennia across cultures. The specific idea of 'progress' has since been challenged on various accounts, but everyday concepts of 'development' remain uncritically assumed by mainstream economists and political scientists. The most basic problem for the concept of progressive social change (p.s.c.) is what is the sustainable criterion by which to distinguish it from non-progressive or regressive change? The histories of philosophy and religion provide diverse answers to the question. By contrast, the economic concept of p.s.c. as a higher gross product may be uniform and precise, but it does not stand up to critical scrutiny because it counts the sale of more goods and services as progressive social change, even if these result in increased destruction of property and life (as in increases of GROSS DOMESTIC PRODUCT (GDP) by expenditure on remedying industrial accidents or medical costs and on commodity substitutes for lost environmental goods).

A criterion which meets these problems can be formulated: a social change, x , is progressive if and only if, and to the extent that, x enables a more comprehensive vital life range for society's members in the aggregate (for example, lower disease ratios, higher literacy rates and rising life expectancy). Marxian as well as market concepts of p.s.c. seem in some sense to presuppose this underlying criterion without stating it. Marxists, for example, think of p.s.c. as movement towards a society of productive plenty, free from the oppression of working people, while market advocates claim that market principles maximize people's access to desired goods more efficiently by a competitive

price system. But a *critical test* of the truth of these opposed concepts of progressive social change requires us first to identify to what extent each one's method and metric of value takes into account the reduction or growth of the life capabilities of society's members. A neo-classical market calculus cannot do this in principle because its input-costs and output-revenues are in monetized terms which do not correlate with life gains or losses. A Marxian analysis, on the other hand, adopts as its ultimate ground of p.s.c. the development of society's productive forces. But the correlation assumed between a society's productive force development and the growth of its citizens' vital life capabilities is not self-evident, for even a socialist society's industrialization may systematically destroy biodiverse environments and reduce individual autonomy.

A social criterion of p.s.c. is therefore required to evaluate the principles of any political or economic doctrine or system, especially when its form of social organization is assumed to be self-evidently desirable or inevitable. But general concepts of social progress and change, however opposed and diverse, have typically fixed on some parameter of social power or development – national territorial expansion, technological achievements or per capita money income, for example – while not grounding these conceptions in the life substance of p.s.c.: the advance of the vital life ranges and capabilities of citizen memberships themselves.

See also:

change, regressive

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JOHN McMURTRY

change, regressive

While the language of modern economics and political science has many terms to designate progressive change – 'progress', 'development', 'growth', 'technological advance', 'modernization', 'industrial take-off' (see DEVELOPMENT) – there is no general concept or category to designate regressive social change. This is a telling gap in theory as well as ordinary language for a number of reasons. Social regression occurs in forms other than 'civil war' or 'ethnocidal strife' which are well-known concepts for quite specific and traumatic social regressions. More significantly, societies or social conditions may in fact regress by the very operations of industrialization, capitalization and monetization of economies which are uncritically assumed to be progressive by definition. For it does not follow that such 'modernizations' are, in fact, progressive for the lives and environments of the peoples living under them. Such changes might be documentably regressive for the health and well-being of their populations, as many argue has been the case in large parts of SUB-SAHARAN AFRICA, Latin America and South Asia. A balanced view would be that industrial and capitalist changes can be regressive as well as progressive, and we cannot know the matter *a priori*. Conversely, concepts like 'backward', 'underdeveloped' and 'Third World' (see THIRD WORLD; UNDERDEVELOPMENT) exist to refer to societies and social conditions which have not undergone industrialization or capitalization of their economies, but these terms too express a fundamentally misleading assumption, unless their judgement is based on a sound criterion by which to assess the condition of peoples and environments before and after their industrial or market restructuring. The tendency has been, however, to blinker out these basic problems and to assume such 'development' to be progressive change, whatever the facts of well-being or ill-being of the peoples and environments of the affected societies may be.

This conceptual blindspot has faced unprecedented challenges in recent years from systemic environmental collapses in the wake of global 'development' and by recurrent economic 'meltdowns' following 'rapid growth' and 'free market reforms' (for example, in Mexico, the former Soviet Union and Indonesia). A non-ideological criterion is required here, by which we can distinguish regressive change from what is always assumed to be a pathway of progress just because there are increases in monetized market activities, with decreases conceived as 'necessary adjustments' along the way. Such a framework of judgement is closed against rebuttal by reality. The converse of the criterion for progressive change provides the life-bearings we require here: that is, x is a regressive change if and only if, and to the extent that, x reduces some vital life range of society's members or their environmental life-host (for example, by higher disease ratios or infant mortality rates, reduced literacy or higher education rates, diminishing life-spans or fitness levels, air or water quality declines, or biodiversity reductions). The problem has been that such indicators of regressive change cannot be derived from market coordinates of priced transactions, and that the non-market indicators which do exist have not been formed into a generalizable metric. Prior to these problems has been the more basic problem of the peculiar absence of any general criterion in the social sciences to recognize what regressive change is.

See also:

change, progressive

JOHN McMURTRY

chaos theory

Many writers on war and peace in international relations (IR), reacting to the occasional apparent loss of control by the participating nations over their system, have introduced the concept of crisis instability – large changes

occurring in the international system as a result of small disturbances or affronts: 'for want of a nail, a shoe was lost ... a kingdom was lost'. A standard example of such a system of instability is the outbreak of World War I as a consequence of an assassination in Sarajevo. In other situations, even larger affronts do not significantly disturb international stability – for example, the many nationalist murders in the Balkans in the 1990s. *The disparity between disturbance and its consequence in a single international system is very similar to that presumed in the physical concept of chaos.*

A good physical illustration of the existence and breakdown of order in a system is represented by the behaviour of a river as it flows from a wide, deep unobstructed channel into a narrow, constrained boulder-strewn gorge. The initially slowly and smoothly flowing water – 'laminar flow' – is completely predictable. Knowing the behaviour of the fluid at one point and one time allows one to know the detailed behaviour of the water at neighbouring points at the same time, or at the same point at later times. The fluid is well ordered. This coherence of behaviour – in space and time – is a structure determined by the physical properties of the fluid as expressed in the Newtonian laws of motion. When the water flows into the twisty, uneven channels of the gorge, it becomes 'turbulent' – no longer predictable. Knowledge of its motion at one place tells you nothing about its simultaneous behaviour at neighbouring places or its later motion at the same place. There is no 'connectivity' of behaviour, no structure, no order. The same body of water has passed from structured to unstructured behaviour – from predictability to chaos (and, of course, further downstream might transform back into structured laminar flow again). Any reasonable mathematical model of fluid behaviour must be able to represent these two types of actual fluid behaviour and the transitions between them.

It is thus natural to associate the transition from predictability to 'deterministic chaos' in a mathematical model of the international system with crisis instability and the outbreak of

war in the real world. This association is particularly natural since war has long been associated with the non-mathematical concept of chaos, which bears great similarity to the corresponding mathematical concept. If we wish to make this association, and thus understand the outbreak of war (of or some wars) as the transition to deterministic chaos, we must first believe in the possibility of valid deterministic models for the evolution of international behaviour.

This latter possibility brings the immediate thought: how can nations – each made up of so many people, each of whom often acts in a seemingly random matter – act deterministically? Again, a physical analogy is helpful. A gas is made up of many, many molecules. These individual molecules may be made up of deterministic elements, moving deterministically (as in classical physics) or they may consist of structures obeying the laws of probability (as in quantum physics). In either case, the overall motion of the myriad molecules is completely random. And yet, when examined from the view of the system as a whole, the gas behaves simply and predictably. It obeys deterministic laws which result from the averaging out of the many random subcomponents of the system. (Similar deterministic averages over many random variables form the basis of much common social life – for example, mortality and other insurance tables.) On this basis, we can expect ‘laws’ to govern the interactions of states. Certainly, much of formal history and political science is devoted to the expression of apparent regularities (laws) of the interactions between states. Thus, there is a hope to be able to formulate laws of hostile interactions between nations which can manifest crisis instability – the transition from order to chaos. This transition will then be associated with the outbreak of war.

The usual physical laws of fluid motion, obtained by applying Newton's Laws of Motion to conceptually isolated small sections of the fluid, are non-linear: the effects of small changes are not necessarily proportional to the changes – the response of the system to small

input changes depends not only upon the system variables and the changed inputs, but also on the response itself. The solutions to such equations have regions in which small disturbances remain small, others in which the disturbances grow. In the latter regions, two solutions that start off very close to each other (differing only by a small ‘disturbance’) soon bear no resemblance to each other. This makes prediction in such a region impossible since any measurement, required to specify the starting solution on which a prediction might be based, will be subject to unknown small disturbances – ‘experimental error’. The system parameters, distinct from its solutions, are also subject to small disturbances – from the measurement process and because they represent the fluctuating interactions of the system with the rest of the world. This situation, in which deterministic theory precludes prediction, in which the ever-present small random disturbances lead to wildly fluctuating incoherent motions, is called ‘chaos’. It is just what is needed to describe turbulence. Thus the same theory can represent both laminar flow and turbulence – it all depends on the input parameters: mean fluid velocity, channel size, viscosity and so on. Though the theory cannot predict what happens in the chaotic regime, it can predict the regimes in which turbulence is possible; it allows calculation of those parameter values that bound the chaotic region.

In practice (for example, the design and operation of an aircraft), it may be desirable to avoid turbulent fluid flow (of air over the wings) since it may make control difficult or impossible. Control implies predictability. Hence, the theory allows the rational placing of constraints on design and manoeuvre behaviour as to avoid turbulence. The theory allows a *prediction of unpredictability*. A corresponding IR theory might allow the prediction of the loss of controlled behaviour by nations within an international system – which we then use to represent the outbreak of war – and thus allow it to be avoided, if so desired.

A Quaker imbued with the possibilities of human betterment and growing to maturity in

the era of expanding technology and improving human life in Europe before World War I, L.F. Richardson was appalled by the carnage and destruction of that war. It could not be the result of a human will, presumed to be striving towards universal health and prosperity, since it led to such universal human disaster. Therefore, he sought to identify the origins of the war in the properties of the international system rather than in human volition. It certainly seemed to many observers that World War I occurred against the wishes of everybody. The lack of human will and control in the outbreak of the war meant that it was the result of the inexorable laws of the system of nations. The system he saw at that time was an arms race, and so he proceeded to mathematize the obvious characteristics of such a race: the rate of arms acquisition of each pair of hostile powers (he didn't explain the origin of hostility but took it as a given) depended on the size of the existing stocks of arms held by the opponents. The result was a linear set of differential equations which has generated much analysis and discussion in the political science community since their introduction. One class of relations between the coefficients (of proportionality between rate of arms stocks increase and size of arms stocks) determining the differential equations led to decreasing armaments for all opponents, no matter what their initial stocks were. Richardson called such a system 'stable' – it would remain peaceful, no matter how hostile the feelings of the nations for each other. Another class of coefficient relations produced solutions which represented constantly increasing stocks of arms, no matter what the initial stocks were. This exponential growth of armaments was claimed to be 'unstable' – it would lead to war. To avoid war, change the system so that the coefficients representing it fell into the appropriate class.

The exponentially growing solutions of these *linear* Richardson equations show no change of form, no structural transformations, no loss of predictability, and hence no loss of control or order. Slight changes in the initial values of the arms stocks or of the system parameters led to slight – but predictable – changes in the

resultant arms supplies. There is nothing in his linear mathematical model that could be interpreted as 'crisis instability'.

But the Richardson approach can be non-linearized: the response (the acquisition of additional arms) of one nation to the arms supply of a second nation can be made to depend not only on the arms stocks of that second nation but also on the anticipated response of the second nation to the response of the first nation. These resultant equations then have solution classes that represent predictability and classes that represent chaos. Solutions are created numerically on a desktop computer for a broad variety of initial conditions. The class into which each solution fits is found by having the computer examine the results of small random changes in the specified initial conditions. If the changes grow exponentially, the solution is in the chaotic class. Analysis of the equations can determine the critical model parameter relationships that produce solutions on the boundaries between the chaotic and predictable regions. When the model parameters reach these critical values, the model will exhibit transitions from predictability to chaos; the international system being modelled is on the brink of crisis instability. If war is to be avoided in the real system, its behaviour – as presented by the model coefficients – must be changed so as to avoid the transition values. The response rates of each nation to the activities of the others must be kept less than the critical values.

Since the non-linearized Richardson equations represent the interactions between competing states, changes in the forms of these equations represent corresponding changes in the nature or dominant characteristics of international relations. Thus questions about the outcomes of particular types of organization of the international system can be addressed via stability investigations into the corresponding sets of equations. For example, a question particularly pertinent today, after the demise of a COLD WAR world dominated by two 'superpowers', is whether a bipolar world is more or less stable than a multipolar world. Aside from academic interest, the question has

great practical impact: Do we have to be more or less careful in making policies for peace in today's successor to a bipolar world? A simple approach to this question, leading to an unambiguous answer, is to take a non-linear Richardson model of a two-nation arms race and bring in a third nation, arms-racing with the first two, via a coupling parameter which can vary from zero to one. A zero-value means that there is no coupling of the third nation to the first two: the system is a bipolar arms race. Where the parameter reaches a value of unity, the model represents three equivalent nations, each racing for arms with the other two: a fully tripolar world. With a fixed value of the coupling parameter, the size of the region of stability of the model (as measured by the allowed ranges of values of the other model parameters that produce predictive classes of solutions to the model equations) is determined. It is found that the stability region shrinks as the coupling parameter is increased. This implies that the system becomes more and more unstable as it departs further and further from pure bipolarity. Other, more traditional, political science grows and thrives via the confirmation of its results by many different procedures. Hence, this simple mathematical model, invoking chaos as a representation of crisis instability, is a valuable adjunct to conventional political science.

Similarly, the question of whether a world system of democratic states is more or less stable than a system of autocracies has been addressed. Here, the model's rate parameters represent averages, over the decision-making populations of the nations involved, of hostile feelings towards competing outside nations. From sampling theory, the range in parameter values produced by a set of autocracies is greater than that produced by a corresponding set of democracies. Lesser values of these parameters mean more stability – less chance of war – among a set of democratic states. Again, similar results have been obtained by other, less model-orientated approaches. The method has also been used to examine the relative stability of balance-of-power worlds versus systems made up of nations, each of

which stands alone against the rest; the chaos domain analysis comes down on the side of those who maintain that balance-of-power (nations combining their 'power' in shifting alliances to balance the power of the dominant nation at the moment) is the more stable regime.

The above three examples of 'chaos analysis' of the origin of war (disassociation of the usual international structure) have used military 'capability' of the competing nations as the dependent variables. A more realistic model would also include 'intent' of the nations towards one another: intent incites capability and capability modifies intent. (The whole point of verification of arms agreements is to modify ones intents towards another nation on the basis of its observed military capabilities.) Furthermore, military capability depends on overall economic strength that in turn is strongly dependent on inter-nation intents. The resultant combined model, including military and economic capability, as well as inter-nation 'relations', is much more complex – it contains many more parameters, all of which are difficult to obtain from real-world data. Thus specific conclusions are harder to obtain. However, again some familiar qualitative results can be simply obtained: war will not occur if 'military-industrial-governmental complexes' have no significant influence upon the evolution of overall economic-political power; nor will it occur if changes in military capabilities do not lead to changes in national intent towards other nations.

Fundamental to the chaos paradigm is the pervasive presence of small random disturbances from outside the model in question: 'small' in that the system changes produced in any single stage are much less than those due to the deterministic rules of change; 'outside' in that they arise from the experimental errors which always accompany any determination of system parameters and/or the interactions of the (necessarily) finite system with its surroundings. These disturbances prevent the 'precise specification' of condition called for by the fundamental assumption of the theory. The future evolution of the system is due to the

repeated *deterministic* iterations of the interactions between its elements. If the repeated random disturbances cancel one another out (as they *must* in a linear system), so that the net influence of these fluctuations remains small compared to the changes resulting from the deterministic laws of interaction, the model implies prediction and control of the system. If the disturbances do not cancel but grow and feed on each other (as they *may* in a non-linear system) so that the result is a cumulative random change comparable to, or greater than, the corresponding deterministic change, prediction is impossible – contingency rules. Whether or not the random perturbations cumulate depends on the details of the deterministic laws of interaction, as well as on the specific configuration of the system's elements. Thus granting the premises, we have an explanation for the contingent origin of war.

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Richardson processes

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ALVIN M. SAPERSTEIN

Charter of Economic Rights and Freedoms of States

The Charter of Economic Rights and Freedoms of States was adopted by the UN Geneva Assembly in 1974 by a vote of 120 to 6, with the United States and Britain opposed. Instituted one year after a US-influenced military coup d'état in Chile, it recognized:

the sovereign and inalienable right of every state to choose its economic system as well as its political, social and cultural systems in accordance with the will of its people without any outside interference.

It also recognized the right of every state 'to regulate and exercise authority over foreign investment', 'to regulate and supervise the activities of transnational corporations' and to 'nationalize, expropriate or transfer ownership of foreign property ... [with] appropriate compensation'. The charter further obliges states both to cooperate in the achievement of 'the restitution and full compensation for the exploitation and depletion of the natural resources of developing countries' and to seek 'appropriate measures designed to attain stable, equitable and remunerative prices for primary products'. More generally, the charter declares 'the sea-bed and ocean floor ... the common heritage of mankind' and states that 'all states have the responsibility [to] ensure that activities within their jurisdiction do not cause damage to the environment'.

The charter might be described as at once the most important and the most ignored modern instrument of international law governing the relationships between nations. It has been ignored by the principal international investment and trade agreements since, but its terms have been a normative touchstone for non-governmental agencies and movements in opposition to these agreements which, it is argued, override the prior authority of the charter.

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JOHN McMURTRY

Chenery, Hollis Burnley (1918–94)

Hollis Chenery was born in Richmond, Virginia. He obtained degrees in mathematics (University of Arizona, 1939) and engineering (University of Oklahoma, 1941) before switching to economics with an MA from the University of Virginia (1947) and a Ph.D. from Harvard (1950). His career has alternated between academia – Stanford, 1952–61; Harvard 1965–70 and 1982–8 when he was named Professor Emeritus – and government – the US Economic Cooperation Administration (1949–53), the UNITED NATIONS ECONOMIC COMMISSION FOR LATIN AMERICA (ECLA) (1957–8), the US Agency for International Development (1961–5) and the WORLD BANK (1970–82).

Without doubt, Chenery has been pre-eminent in the emergence of quantitative development economics in what may be called an Anglo-Saxon structuralist tradition (as opposed to Latin American structuralism – see STRUCTURALISM), with early influences from JAN TINBERGEN, Simon Kuznets and

Wassily Leontief (Chenery, 1992). Chenery has defined economic DEVELOPMENT as

a set of interrelated changes in the structure of an economy that are required for its continued growth. They involve the composition of demand, production and employment as well as the external structure of trade and capital flows. Taken together, these structural changes define the transformation of a traditional to a modern economic system.

(Chenery, 1979: xvi)

For Chenery, ‘structure matters’. Structure imposes constraints on growth and changes in structure can generate growth. Development policy is concerned with the management of structural change and with ‘the development of feasible combinations of market forces and government intervention that make this task possible’ (ibid.: 2).

Chenery and various collaborators have pioneered the development of comparative econometric studies to identify uniform patterns of change (Chenery, 1960; Chenery, Robinson and Syrquin, 1986). Industrialization plays a strategic role in the development process (Chenery, 1955) and Chenery (1961) notes the possible conflict between trade theory and development theory. The availability of foreign exchange (see TWO-GAP MODEL) may also constrain economic growth (Chenery and Strout, 1966). Chenery *et al.* (1974) refocused attention on income distribution and economic growth (conceptually different from, but in practice complementary to, the basic needs strategy of the INTERNATIONAL LABOUR ORGANIZATION (ILO)) and, until the neo-classical counter-revolution took full hold in the 1980s (see NEO-CLASSICAL ECONOMICS), redistribution with growth generated much discussion.

Chenery’s other major contributions span, *inter alia*, engineering and constant elasticity of substitution (CES) production functions, investment criteria, input output analysis, programming models and computable general equilibrium models (CGEs) (Syrquin, Taylor and Westphal, 1984). His work has always

emphasized the complex interrelations between sectors of the economy and the role that planning has in overcoming the rigidities or constraints which characterize the less developed economy.

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mance: Essays in Honor of Hollis B. Chenery, Orlando, FL: Academic Press.

FREDERICK NIXSON

Chicago School

The Chicago School of Economics had its origins in the early 1930s at the University of Chicago's Department of Economics. However, the economics department maintains many close ties with the university's Schools of Law and Business. Also, a growing number of highly influential graduates around the world: academics, finance ministers and central bankers are also considered 'members'. Numerous 'Little Chicagos' (like the economics department at UCLA) have also sprung up.

The two main characteristics of the Chicago School are a belief in (1) the power of neo-classical price theory to explain observed economic behaviour, and (2) the efficacy of free markets to allocate resources and distribute them. Extending these ideas into the area of policy, the school's members usually advocate minimizing the role of the state in economic activity.

The school traces its roots to Frank H. Knight and JACOB Viner, with Henry Simons a lesser known, yet extremely influential figure. Knight (1885–1972) in particular had a lasting influence on the school. Though they were far from being radical advocates of laissez-faire, each rebelled against the collectivist environment of the New Deal in the United States and FASCISM and COMMUNISM in Europe. In doing so, these economists instilled in their students an appreciation of the price system and a competitive market order. And they warned of what collectivism could mean for the loss of political and civil liberties.

Unfortunately, much of the early Chicago School's philosophy and methodology was never published. Instead, an oral tradition was developed and carried on after World War II by a group of economists, of whom George Stigler and MILTON FRIEDMAN were the most influential. Stigler and Friedman's

Chinese walls

work left a lasting imprint on the Chicago School and many of the specifics as to what constitutes the Chicago School are derived from their research and writings.

The main contributions from Stigler, a student of Knight's in the 1930s, have been in the area of the theory of markets and prices, the economics of information, the theory of monopoly and the theory of government regulation. Stigler demonstrated how markets enable individuals with less than perfect knowledge to search for information about the qualities of goods and the prices at which they may be obtained; he further showed how competitive forces tend to bring supplies and demands into balance through this process of searching for information. Stigler also pioneered research in the field of government regulatory policy. Stigler's work demonstrated that rather than serving the public good, regulatory agencies invariably came under the control of the industries they were to regulate.

Milton Friedman joined the Chicago economics faculty in 1946. His work over the next thirty years focused on studies of money and monetary economics, taxation, consumption, the uses and abuses of the theory of price, and the theory of human capital. In a monumental work, *A Monetary History of the United States, 1867-1960* (Friedman and Schwartz, 1963), Friedman explained that a stable growth of money supply is not feasible under a regime of fixed exchange rates. His advocacy of flexible exchange rates followed his contra-Keynesian view of the efficacy of free markets. Yet, in spite of increasing the degree of attention paid to the BALANCE OF PAYMENTS and the money supply process, the prime focus of Friedman's work was the examination of the effects of monetary variations on nominal income, prices and output. In essence, Friedman found that variations in the rate of growth of the money supply had short-run effects, but in the long-run (more than three years) the only substantial effect was on prices. This work linked the classical tradition of Knight, Viner and Simons to the frontiers of modern macro-economics.

The tradition of Knight, Viner, Simons, Friedman and Stigler has carried on to a new

generation at Chicago, many of whom have extended the basic tenets of the school to new and exciting areas. To date the school has had nine Nobel Prize winners: (1) FRIEDRICH VON HAYEK, 1974 – Economics and Institutions; (2) Milton Friedman, 1976 – Monetary Economics; (3) Theodore Schultz, 1979 – Economic Development; (4) George Stigler, 1982 – Industrial Organization and Regulation; (5) Merton Miller, 1990 – Corporate Finance; (6) Ronald Coase, 1991 – Property Rights; (7) Gary Becker, 1992 – Non-market Behaviour; (8) Robert Fogel, 1993 – Economic History, and (9) Robert Lucas, 1995 – Rational Expectations.

See also:

Keynesian economics; neo-classical economics; neo-classical economics, critique of

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ROBERT LOONEY

Chinese walls

A Chinese wall is a barrier designed to separate the corporate finance, investment banking and research departments of a multinational bank from the sales and trading departments. In their commercial role, banks often acquire information regarding new equity and bond

offerings, hostile takeovers, demergers and spinoffs, and other pending transactions. A potential conflict of interest arises when the trading departments of banks act upon or divulge to customers knowledge of such transactions. A traditional response to these conflicts is to segregate the different units into separate legal entities. Yet subsidiarization is presumed insufficient to restrict the flow of information. Legal separation supported by Chinese walls would normally provide an effective response to conflicts of interest.

National regulators and stock exchanges require banks to take reasonable steps to limit the release of price-sensitive information to third parties. The creation of Chinese walls means that banks must not only impose physical restrictions and procedural controls, but the measures should be designed in such a manner that employees are aware of the existence of Chinese walls at all times. Banks must impose obligations on personnel who are in possession of price-sensitive information and advise them against trading or releasing price-sensitive information. As would be expected, a bank is obliged to appoint a compliance officer who is responsible for the maintenance of the Chinese walls as well as the enforcement of the company's internal rules. Compliance officers are often responsible for instructing staff how to comply with the various legal and non-legal rules.

It would seem that Chinese walls are simply expected to regulate a considerable number of conflicts of interest which, due to the competitive nature of financial services business, cannot be effectively restricted (for example, 'front-running'). While there is scope for further restrictions on the information banks can disclose, it is possible that an approach whereby self-regulation is encouraged and enforced is more likely to offer an effective response to these concerns than the imposition of stricter regulation.

JOSEPH McCAHERY

chlorofluorocarbons (CFCs)

Chlorofluorocarbons (CFCs) are chemicals widely used since their discovery in the 1920s as propellants in aerosol sprays and as cooling liquids in refrigerators/air conditioners: the residual chlorine was thought to be inert but in 1974 scientists suggested that it rose into the stratosphere where it destroyed ozone. A hole was discovered in the southern hemisphere's ozone layer, which allowed increased ultra-violet radiation to enter the atmosphere, generating more skin cancer cases and contributing to global warming.

International attempts to end the use of, and trade in, CFC-based technologies, in order to remove the threat to the ozone layer, illustrate the problems of gaining agreement for resolutions of global environmental problems. In 1985, twenty-eight states signed the Vienna Convention on the Ozone Layer, which was extended by further protocols agreed at Montreal in 1986 and 1990 (signed by forty-six states, though ratified by only fifteen). The goal was for individual countries to agree targets for phasing out CFC production and use quickly, with developed countries providing aid to developing countries to assist them in doing this. It stimulated substantial early resistance from chemical manufacturers, who successfully lobbied governments (especially the United Kingdom and the United States) not to sign until alternatives to CFCs, which are very cheap to produce, were available. (Their stalling tactics included questioning the science.) When that happened, a 1992 Copenhagen conference agreed to phase out production by 1996, and a three-year, \$500 million aid package was created: the US government was reluctant to allocate new money to this and successfully demanded a permanent position on the fourteen-country committee overseeing allocations from the aid fund. Whether ozone depletion has been halted by this programme remains a moot point, however.

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RON JOHNSTON

CITY, THE see London, City of

civil society

This term has undergone changes of meaning in the history of social thought, which has led to a situation in which the emergent contemporary usage conveys almost the opposite of its original meaning. Three major meanings of civil society may be identified. In its earliest appearance, it denoted the political sphere in which people lived under a common power. It later referred to market society. Later still, it is used to identify the sphere of non-state associative activity. Hence the meaning has shifted from something close to 'the state' to something close to the 'non-state'. Since what the concept denotes has depended heavily on how it has been used in self-conscious contrast to other concepts, exploring these contrasts will explain the apparent puzzle of this shifting meaning.

In seventeenth-century writing, civil society referred to politically organized society (Lively and Reeve, 1997). John Locke's civil society was the product of a social contract and the relevant contrast for civil society was a 'state of nature'. Both THOMAS HOBBS and Locke pointed to the benefits of civil society over such a natural state, although they of course differed about a number of important issues. Three such points of difference were whether any sort of settled society could exist without

political organization, the nature of political power, and the proper extent of the powers of the sovereign or government. For Hobbes, life in the state of nature was intolerable and no society was possible. Locke, however, envisaged settled institutions. For Hobbes, the state of nature was a war of all against all, but for Locke it could be peaceful much of the time. Political power for Hobbes was overwhelming coercive power; Locke placed greater emphasis on the promulgation and enforcement of a settled system of laws designed to promote the public good. Hobbes emphasized the need for the sovereign to have extensive powers and to be above the judgement of his subjects, whereas Locke imagined people in political society giving power on trust to a government to be exercised for limited purposes.

Despite these points of difference, there are structural parallels between the two authors. Civil society results from a social contract because people see either the disastrous consequences of the absence of a sovereign (Hobbes), or the disadvantages of the lack of a constitutional legal-political order (Locke). In short, civil society is the result of an act of will, manifest in the contract. It is intentionally created, an artefact. The artificial order of political society is contrasted with the natural condition of humanity, the state of nature, in which there is either no order at all (Hobbes), or there is a limited order produced by individuals' adherence to the laws of nature (Locke). The characteristics associated with civil society in this first sense – sovereignty, political organization, a legal system claiming legitimacy – came to be seen as identifying the state, and this left the notion of civil society available for use in a different way.

The second meaning of civil society emerged from the intellectual endeavour to analyse the workings of the market economy. ADAM SMITH (1976 [1776]) famously asserted that people have a natural disposition to truck and barter, which has historically led to the development of a commercial society. In *The Wealth of Nations*, Smith attempted to explain the operations of this society, in which market exchange is the predominant form of transac-

tion. He was particularly interested in how prices are determined, how wages, rent and profit are set, and in the theory of growth. He developed the idea of the market as a system, having 'natural' workings, and helped thereby to develop the very concept of 'the economy'. 'Civil society', in its classical usage, came to be identified with market society. Its major characteristics were ubiquitous market exchange, an extensive division of labour and complex interdependence. This interdependence arose, of course, from the division of labour, but competitive markets were also thought to disperse power. Individuals all depended on the market, but not directly on specific other individuals, in contrast to earlier historical social formations. Civil society could be thus seen as a form of natural social order.

The 'naturalness' of civil society, at least in Smith's theory of commercial society, arose from two connected considerations. First, Smith proposed a theory of history, according to which the modes of subsistence that people had created or experienced were four: hunter-gatherer, pastoral nomadic, agrarian and commercial. Smith unfolded a hypothetical history of these modes of subsistence, in which 'development' was driven by the natural impulse to truck and barter, and (presumably, because he was not explicit about this) rational responses to scarcity. So commercial society was historically the product of 'natural' characteristics of 'human nature'. Second, commercial society could be analysed, in its internal workings, by reference to those alleged 'natural' characteristics.

The sense in which civil society was ordered is related to the famous metaphor of the *INVISIBLE HAND*. Smith noted that the market was able to meet wants or needs in a way which suggested the existence of a benevolent guiding hand. But, of course, he went on to point out that both the benevolence and the guiding hand were illusory. Market activity depended on the pursuit of self-interest, although it harnessed that pursuit to general welfare, and there was certainly no guiding hand, other than the 'natural laws' of the operation of the market. Conceived in this way, the 'order' of

the market was an unintentional consequence of the universal pursuit of self-interest. Hence civil society was a natural moral order: its operations were explicable by reference to human propensities, it served general human purposes and it achieved its results without direction, with the appearance of benevolence, but guided entirely by the general interaction of self-interested actors.

This conception of civil society, elaborated most famously by the philosopher G.W.F. Hegel (1952), enables new contrasts to be drawn. On the first conception of civil society, associated above with Hobbes and Locke, civil society was the name for a willed political order, in contrast to the natural state of humanity in the absence of self-conscious political organization. Political society – civil society in that conception – was an artificial construction, designed to secure particular purposes. But if the state – as it came to be called – was an artificial construction, civil society in the second conception was a natural social order. So the naturalness of civil society could be contrasted with the artificiality of political society. Whereas the social contract supposed some collective act of will aiming to produce a desired outcome, the theory of the market proposed that market order was the unintended, if benign, consequence of individual action aimed only at the promotion of self-interest. Hence, 'civil society' could now be contrasted with 'the state', a contrast quite impossible on the first conception of civil society.

The contrast between the state and civil society was not confined to those who subscribed to the social contract theory of the origin of the state. Hegel was himself a vehement critic of that theory, since for him the state was the product not of will, but of rational necessity. Nevertheless, he contrasted the universal pursuit of self-interest in civil society with the ethical principles underlying both the family and the state. From this viewpoint, both 'civil society' and 'the state' were in a sense 'natural', but civil society could not be the highest expression of freedom precisely because it was rooted in self-interest,

however all-embracing the division of labour and the 'system of needs' had become.

Hegel's political philosophy distinguished the family, civil society and the state as three moments in ethical life, but other contrasts helped give meaning to 'civil society'. Ferdinand Tönnies (1955) distinguished *Gemeinschaft* from *Gesellschaft*, 'community' from 'society': his understanding of 'society' was certainly of the market or 'civil society' that we have been concerned with under the second dominant understanding of the term. But modern usage has produced a third understanding, under which these distinctions become less sharp, or perhaps are considered less important (Tempest, 1997). If the first meaning was associated with the search for legitimate political authority and the second with the attempt to understand the order of the market, the third seems to be related to the collapse of communist regimes and the search for the bases of free association. Communist regimes penetrated deeply into social life of all kinds. In the process of democratization or liberalization of societies which experienced that penetration, the suggestion was made that 'civil society' needed to be developed. 'Civil society' is certainly still contrasted with 'the state', and it embraces market institutions, but it also emphasizes the voluntarism of social engagement beyond the individual and the family. It is the sphere of voluntary associations, of collective endeavour which may be 'political' but which is essentially intermediate between the individual and the state. The notion of order, present in different ways in the first two meanings, has a different nuance: civil society is to be promoted as providing a framework of social order and cohesion in the wake of a retreating state.

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ANDREW REEVE

class, abstract

Abstract conceptions of class form the basis of the most important insights of KARL MARX into the underlying dynamics of CAPITALISM. They aim to establish a general representation of major classes in capitalist societies and to identify tendencies inherent in their development. Marx's class abstractions are not, however, generally applicable categories that can hope to explain the intricacies of each and every social formation, nor are they literal descriptions of the class structure of any particular capitalist society. Rather, they are real social processes reflected in thought which help to reveal the essential class dynamics of the capitalist MODE OF PRODUCTION.

The most powerful and systematic attempt to advance such abstractions is to be found in the *Communist Manifesto*, where it is argued that

society as a whole is more and more splitting up into the two great hostile camps, into two great classes directly facing each other:

bourgeoisie and proletariat.

(Marx and Engels, 1998 [1848]: 35)

While the former profit from their ownership of the means of production, the latter have no means to live other than by selling their labour. The growing immiseration of the proletariat that results is the impetus for an increasingly fractious political struggle between capital and labour which, in time, signals the eventual destruction of capitalism. Despite one or two fragmentary notices that suggest the possibility of a more complex abstraction of class dynamics in the capitalist mode of production – one that might, in particular, account for the persistence of a middle strata – Marx basically adhered to this idea of simplification throughout the development of his political economy.

However, since Marx, the evolution of classes in capitalism has suggested that they tend less towards simplification than complexity. This has led a number of neo-Marxist class theorists (see NEO-MARXISM) to question Marx's original abstract model and to attempt to revise it in order to account for the growth of a middle class (see CLASS, MIDDLE) in most advanced capitalist societies and the apparent lack of class conflict that was supposed in the original scheme.

See also:

class, definition of; class formation; class, taxonomic problems of; Marxian economics

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ROHIT LEKHI

class, definition of

Class is a concept that has several contextual meanings. Class may be defined in terms of simple gradations based on material conditions. The main body of class analysis is based on the Marxist and Weberian approaches. The Marxist conception of class defines it as a group of people with a common relationship to the structures of political and ECONOMIC POWER within a particular SOCIETY. The Weberian perspective views class as a group of individuals who are categorized according to common socioeconomic indicators that are termed 'life chances'.

While the Marxist and Weberian approaches differ in many respects, they share three important characteristics. First, both approaches hold the control of economic resources as central to class analysis. Second, the approaches define a particular class location in relation to its links with other class locations. Third, they both view class as an explanatory factor in determining the means and limitations of an individual's pursuit of material resources, such as income.

The gradational notion of class is the study of a particular society based on the inequalities of income and standard of living. The gradational perspective divides class in terms of higher, middle and lower. These classifications are subdivided into lower middle class, upper middle class and so on. While each class brings with it various connotations, either positive or negative, a great deal of vagueness exists between each class division. Furthermore, the gradational notion of class has little explanatory use in terms of class analysis.

The Marxist analysis of class is particularly useful in clarifying the above gradations of class. For example, some individuals who would be considered part of the working class actually earn more income than those of the middle class (see CLASS, MIDDLE; CLASS, WORKING). This lack of clarity provides a strong argument in favour of classifying all wage-earners as part of the working class and those who have an independent means of

class, definition of

self-employment as part of the middle class. KARL MARX defined class in terms of the relations between structures of political and economic power. Marx argued that these structures of POWER are based on the ownership of the means of production. While Marx never elucidated it in a systematic manner, class has a central importance in Marxist theory. Marxists divide classes in the following way. The capitalist ruling class, or bourgeoisie, owns and controls the means of production. The middle class, or petty bourgeoisie, has an independent means of self-employment through special artistic or technical skills. The working class, or proletariat, only has its labour to sell to the bourgeoisie in order to earn WAGES. The wages earned by the proletariat are significantly less than the profits that are earned for the bourgeoisie; therefore, the bourgeoisie is seen as exploiting the proletariat.

To end this EXPLOITATION, Marxists argue that the proletariat must become cognizant of both itself and the fact that its interests are in complete opposition to those of the bourgeoisie. Class consciousness is the awareness by individuals in a particular societal group that they belong to a distinct class. Marxists contend that the formation of an antagonistic class consciousness will unite the proletariat and lead them to wage a successful CLASS STRUGGLE with the bourgeoisie.

MAX WEBER perceived class in terms of life chances and the operation of the labour market. Weber defined class as a group of individuals who have similar opportunities, or life chances, to attain comparable types of occupations and income. Occupational income is based on supply and demand within the labour market. The opportunities primarily consist of the possession of property or a high level of education. Within each class, numerous status groups exist, ranked according to occupation and income. Since supply and demand within the labour market is subject to change, the ranking of various status groups within each class is also subject to change.

Weberians and Marxists interpret the ruling class in much the same way. The Weberian approach defines the ruling class as those

individuals that own large properties, such as factories. The ruling class purchases labour from the middle and working classes at market prices. The ruling class also has both a high level of social status and a great deal of political influence. The middle class is a group of individuals who have similar opportunities to earn relatively high levels of income based on occupation. Occupations that demand less skill or education may draw from a larger body of applicants because most individuals are able to perform the tasks required. If the labour supply is high, then the wage that the employers are willing to pay is low. Consequently, the working class tends to comprise those individuals that earn a relatively low income. Individuals within the working class have so few opportunities because they rarely either own property or possess a high level of education.

Class may be defined along a continuum of positions, ranging from simple gradations to elaborate arguments within the Marxist and Weberian schools of thought. Marxist theory, if true, has substantial explanatory and predictive capacity in terms of class analysis; Weberian theory, if accurate, provides a framework for class analysis that is flexible and highly descriptive. It is through the analysis of class that the concept of class gains a certain solidity and empirical relevance.

See also:

class formation; class in state socialism; class, Weberian approaches to; Marxism-Leninism

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J. ANDREW GRANT

class formation

'Class formation' refers to the process by which classes emerge *in* history – their development in concrete terms as collective actors. It encompasses the multitude of circumstances and events – structures, institutions, practices and values – that shape the emergence of classes in all of their specific political and ideological forms.

In his attempt to isolate the abstract tendencies in the development of classes in the capitalist MODE OF PRODUCTION, KARL MARX distinguishes between two dimensions of class formation: objective and subjective. The former establishes membership of distinct classes through the structural relationship of social groups to the means of production. There are those who own the means of production – the bourgeoisie – and those who are forced to live by selling their labour – the proletariat. According to Marx, this process of transforming the vast majority of people into workers (that is, wage-labourers) under conditions of domination by capital already establishes that group as a class-in-itself – a class already in common location with common interests.

However, the subjective dimension of class formation only arises when a class-in-itself becomes conscious of that commonality in the course of political struggle. Initially, such struggles may be limited to localized disputes between, for example, a specific group of workers and individual employers. However, in the face of the growing immiseration of all workers and their continued ALIENATION from the productive process, the identification of interests widens to embrace an entire class of workers who are able to formalize their

representation institutionally in, for example, political parties and trade unions. It is through this process of developing a conscious and collective identity as a class that the class-in-itself becomes a class-for-itself.

However, it is clear from his analyses of individual societies that Marx was acutely aware of the difference between class formation conceived in these abstract terms and understood as the complex development of collective actors at any specific historical juncture. In particular, he recognized the discontinuities that arise in concrete societies between the objective and subjective dimensions of class formation, between the already established fact of a society's class structure and the rather more complex development of its political expression. So, for example, narrow sectional interests among specific groups of workers often conflict with the long-term interests of the working class as a whole. Equally, the development of a collective class identity can often be inhibited by the persistence of antagonisms around, for example, race, gender, ethnicity and culture. It would be wrong to suppose, then, that Marx assumed a simplistic translation from objective class structures to subjective constructions of collective identity and consciousness. However, it is certainly the case that the problem of discontinuity between the objective and subjective dimensions of class formation was only ever a political problem for Marx, to be resolved in the course of CLASS STRUGGLE.

Modern-day Marxists do not, however, share these confident predictions. Despite two or more centuries of political conflict around class antagonisms, the disjunction between the objective and subjective dimensions of Marx's scheme appears no nearer to resolution. Consequently, this has called into question a number of features of class formation as originally conceived: whether the relationship between the class structure of a society and its political expression is a great deal more complex and contingent than even Marx at his most historically sensitive supposed; whether class structures in the capitalist mode of production tend to something more elaborate than a two-class simplification supposes,

class in state socialism

and, finally, whether in fact the distinction between objective and subjective dimensions of class formation is sustainable at all.

See also:

class, abstract; class, taxonomic problems of; economism

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ROHIT LEKHI

class in state socialism

STATE SOCIALISM is a system of government wherein the STATE directs the economic DEVELOPMENT of the country through its ownership of all industrial, commercial, productive and distributive sectors of the economy. State socialism is most often associated with the type of government that existed in the Soviet Union and the socialist countries of east central Europe. Class relates to how people within a particular SOCIETY are divided into groups according to their relationship to the structures of political and ECONOMIC POWER. Under state socialism, EQUALITY was supposed to exist because the proprietary classes were abolished. Officially, each citizen was considered equal. In theory, everyone belonged to the proletariat (see CLASS, WORKING), since each employee was paid by the state. In practice, however, a certain level of class distinctiveness, or social stratification, was evident. The intelligentsia,

Communist Party officials and members of the government comprised a 'new' ruling class, although not in the classical Marxist sense of the term. These three groups did not own the means of production; however, they did hold most of the political power due to their elite status in state-socialist societies, and received the privileges and authority that came with being the ruling class.

See also:

class, definition of; communism; Marxian economics; Marxism-Leninism; socialism

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J. ANDREW GRANT

class, middle

The definition of the middle class is subject to the theoretical approach adopted. The Marxist analysis of class places the middle class (the petty bourgeoisie), between the capitalist ruling class (the bourgeoisie) and the working class (the proletariat – see CLASS, WORKING). The bourgeoisie owns and controls the means of production, while the proletariat only has its labour to sell in order to earn income. Members of the petty bourgeoisie have an independent means of earning money, such as self-employment through the use of special creative or technical skills.

The maximalist approach holds that mental labour, such as supervisory and professional occupations, are part of the middle class despite the fact that these types of occupations are wage-earning and produce profit for the capitalists. Non-productive labour, which is paid out of profits, is also part of the middle class. The minimalist approach contends that

all occupations, either productive labour or non-productive labour, are exploited and thus cannot be considered middle class.

The Weberian approach views the middle class as a group of individuals who have similar opportunities to earn relatively high levels of income based on occupation. Occupational income is based on supply and demand within the labour market. Subsequently, middle class may be defined according to national median incomes.

See also:

class, definition of; class formation; class, service; class, Weberian approaches to; Marxism-Leninism

Further reading

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J. ANDREW GRANT

class, service

The rise of the 'service class' – the class of professionals, administrative and managerial employees – is a recent development in advanced capitalism. The service class accounted for only 5–10 per cent of the active population in even the most advanced capitalist countries in the early twentieth century. However, in advanced capitalist countries, it generally accounted for 20–25 per cent by the late twentieth century.

According to John Goldthorpe (1982), two organizational exigencies have laid the foundation for the rise of the service class in advanced capitalist countries: (1) the need to delegate authority (met chiefly via the administrative-managerial function) and (2) the need to draw on specialized knowledge and expertise (met chiefly via the professional function). In direct consequence of the element of trust that is thus

necessarily involved in their relationship with their employing organization, members of the service class are accorded much better conditions of employment than both the routine non-manual workers (for example, clerical and sales workers) and the manual labourers.

Goldthorpe argues that the service class has a substantial stake in the status quo and that its members will act in the way that is characteristic of members of the privileged strata: that is, that they will seek to use the superior resources that they possess in order to preserve, for themselves and for their children, their positions of relative social power and advantage.

See also:

class, middle

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ALVIN Y. SO

class struggle

According to KARL MARX, class struggle is the principal dynamic of all historical development. Although there is some disagreement among Marxist historians about the specific importance of class struggle in pre-capitalist societies, it is most often assumed to be a feature of any and every historical period within which one class is able to live off the productive activity of another. Under CAPITALISM, class struggle is based on the universal and permanent antagonism between the interests of capital, which is impelled to maximize profit ever more efficiently in the process of continued accumulation, and labour, the continued existence of which is threatened by this self-same process. In its phenomenal form, class struggle represents the growing political

class, taxonomic problems of

and social conflicts that arise between the bourgeoisie and working class (see CLASS, WORKING). It is also the medium in and through which the latter becomes conscious of itself and its leading role in the destruction of capitalism, and in the subsequent transition to either barbarism or SOCIALISM.

See also:

class formation

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ROHIT LEKHI

class, taxonomic problems of

Class taxonomy has been the focus of neo-Marxists in the late twentieth century (see NEO-MARXISM). The neo-Marxists spent an enormous amount of effort drawing up maps of class taxonomy so as to delineate the number of classes and their boundaries; they also brought in census or survey data to match the class taxonomy map. Erik Wright (1985), for example, developed an original class taxonomy that centres on the concept of asset exploitation. In Wright's taxonomy, exploitation occurs when the oppressing class benefits at the direct expense of the oppressed. Or, to put it differently, a class is exploiting another class when the former's wealth depends on the appropriation of the fruits of the latter's labour. Based on this definition, Wright suggests that three types of assets (means-of-production assets, organization assets and skill/credential

assets) have led to three forms of exploitation in capitalism. Thus the bourgeoisie exploit through ownership of the means of production; managers exploit through organization assets, and experts exploit through skill/credential assets. In capitalism, the means of production is the dominant form of exploitation, while organization and skill assets are subsidiary.

This class taxonomy exercise is highly problematic and has received two types of criticism. The first, which can be labelled as the 'insider's critique', focuses on whether there is a better definition of class – whether this class taxonomy is an improvement over another. Thus researchers criticize Wright for adopting a 'micro-individual logic' which overlooks the macro-social class structure. They also question whether organization assets and skill/credential assets are really separate dimensions of exploitation from means-of-production assets.

The second type of criticism can be called the 'outsider's critique' because it casts doubt on whether class taxonomy can help to explain the historical trajectories and social change in capitalism. Anthony Giddens, for instance, has found Wright's taxonomy disappointing because it is heavily abstract and typological. In spite of Wright's fairly frequent references to class struggle and consciousness, there is very little life or movement in the material that constitutes the bulk of Wright's book on class taxonomy.

See also:

class, definition of

Reference

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ALVIN Y. SO

class, Weberian approaches to

The Weberian concept of class is defined in strictly economic terms. However, Weberian social analysis is well known above all for the

links it establishes between status groups and classes, and the importance it accords to these links for understanding social and political action and hierarchies.

For MAX WEBER, a 'class' consists of all persons in the same class situation – that is to say, all persons sharing a typical probability of (1) procuring goods, (2) gaining a position in life and (3) finding inner satisfaction to the extent that this probability is derived from their control over goods and skills, and their income-producing uses. Weber repeatedly insists that classes are defined by market situations and that classes are stratified by their relationship to economic power. He sees this as resulting in three possible types of classes based on what kind of market control the class has: property, commercial and social classes (those where individual and generational mobility is relatively easy).

For the sake of understanding social action and hierarchy, classes alone are insufficient. Weber insists that honour is at least as important a reason for action and a source of power. Consequently, he stresses the importance of studying status groups alongside classes. Status is defined by the social estimation of honour and is expressed in the shared lifestyles of the members of a group. If classes reflect the distribution of economic power, status groups reflect the distribution of honour. If classes are defined by the production and acquisition of goods, status groups are defined by their consumption, as expressed through their lifestyle.

Status groups and classes are closely linked to each other. Belonging to a class is often a precondition for being part of a status group. Inversely, belonging to a status group usually confers a number of economic privileges and thereby shapes the economic order and to some extent always hampers the development of a free market. However, status group and class are by no means synonymous. Although they may overlap, they can also stand in contrast to each other. Status may be relatively independent of class situation, and class situation independent of status. Which of the two related hierarchies is dominant is an open issue. Weber

therefore distinguished status societies (stratified primarily by status) from class societies (stratified primarily by class).

The main contribution of Weberian class analysis is the weight put on the relation between classes and status groups, and the importance of this link for the study of social action, social stratification and hierarchy, and political action and power (which Weber sees as aiming at social power, stemming both from the distribution of honour and of economic power). It is the stress on this link and the refusal to make it unidirectional that sets Weberian analysis apart from Marxist analysis (see MARXISM–LENINISM), as well as from analysis where group belonging is made the sole source of motivation for action and of social stratification (for example, Durkheim). It is by the exploration of this link that contemporary class analysis in a Weberian tradition is distinguished.

ANNA LEANDER

class, working

A basic definition of the working class is that it comprises all wage-earners. However, some wage-earners earn more than individuals of the middle class, or petty bourgeoisie (see CLASS, MIDDLE). Hence, the concept of the working class is far more complex because it may be defined in terms of its relation to other classes. A definition of the working class depends on which individuals are to be either included or excluded and for what reasons, and on one's ideological perspective. Working-class formation and working-class consciousness also play a significant role in defining the working class.

The working class began to grow in numbers following the INDUSTRIAL REVOLUTION in Europe and North America in the late eighteenth century. KARL MARX studied the working class and defined it in terms of its relation to structures of political and ECONOMIC POWER. Marx proposed that these structures of POWER are based on the ownership of the means of

production. The capitalist ruling class, or bourgeoisie, owns and controls the means of production. The middle class, or petty bourgeoisie, has an independent means of earning income, such as special artistic or technical skills. The working class, or proletariat, only has its labour to sell to the bourgeoisie in order to earn WAGES. Since the wages are significantly less than the profits that the proletariat makes for the bourgeoisie, the bourgeoisie is exploiting the proletariat. To end this EXPLOITATION, the proletariat must consolidate itself, then overthrow the bourgeoisie.

For Marx, the working class, or proletariat, is extremely important because it is the political force that will eventually displace the capitalist relations of production and bring about a socialist SOCIETY. First, the proletariat must come to develop a class consciousness, which is the awareness that it is a distinct class with common interests. The proletarian class consciousness becomes antagonistic once it realizes that its interests are diametrically opposed to those of the bourgeoisie. The antagonistic class consciousness further unites the proletariat and leads to a CLASS STRUGGLE with the bourgeoisie. Class struggle results in a proletarian revolution, which culminates in the violent overthrow of capitalist forces.

Class consciousness is also an important factor in non-revolutionary analyses of the working class and working-class formation. Working-class formation is a phenomenon that varies from country to country, and from region to region within each country. TRADE UNIONS and workers' movements play an important reciprocal role in the formation of a national working class. Although working-class formation is primarily determined by changing relations of production, workplace relationships, political structures and cultural factors also help in shaping it. To become cohesive, the working class must become self-conscious of its position in the social structure. Once cohesiveness is attained, the working class will be capable of positively affecting its position in society through trade unions and workers' movements.

Nicos Poulantzas (1978) espouses a minimalist definition of the working class. Poulantzas distinguishes between mental labour and manual labour. Mental labour, such as supervisory and professional occupations, belong in the middle class despite the fact that these types of occupations are wage-earning and produce profit for the capitalists. The working class is defined according to manual forms of labour only. Conversely, Paul Baran (1957) contends that all occupations, so long as they earn wages, comprise the working class because they are exploited. In this context, exploitation takes place if the workers do not earn the full amount of the SURPLUS VALUE, or profit, that they produce.

The Weberian approach views the working class as a group of individuals who have relatively few opportunities to attain occupations that pay high levels of income. The working class has so few opportunities because they rarely either own property or have high levels of education. Occupational income is based on supply and demand within the labour market. Occupations that demand less skill or education may draw from a larger body of applicants because most individuals are able to perform the tasks required. If the labour supply is higher, then the wage that the employers are willing to pay is lower. Consequently, the working class tends to consist of individuals who are earning a relatively low income.

See also:

class, definition of; class, Weberian approaches to; communism; Marxism Leninism; socialism

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J. ANDREW GRANT

clearing

In simple terms, 'clearing' is the offsetting of liabilities between two parties, typically involving the collection of funds on which a cheque is drawn and payment of those funds to the holder of the cheque. Institutions such as commercial or MONEY-CENTRE BANKS are organized to settle mutual indebtedness in this way. Clearing is an essential feature of an efficient financial system.

L.S. TALANI

clientelism

'Clientelism' is a personalized form of politics in which resources, assistance and protection are given by a 'patron' to a person or group in exchange for that person or group's allegiance, obedience or vote. Patrons, by definition, are powerful, having access to resources for which their 'clients' must depend on them. Clients, on the other hand, are dependent on the patron. Resources are not distributed according to universalistic criteria in which individuals who meet the criteria are entitled to benefits. Instead, benefits are made contingent on obedience and, often, political support. Clientelism can be exercised at multiple levels, with chains of patron-client links extending from the central leadership all the way to local citizens.

Where the patron is a major political party or a public bureaucracy tied to the party, mass-clientelism exists and public decisions take on the characteristics of commodity exchanges. Anthropologists emphasize the interpersonal nature of clientelism and the role it plays in a group's functions. Political scientists emphasize

the political nature of the relationship and attempt to see how it affects political activity and the preferences of patrons. That view has led some scholars to stress that clientelism is a political strategy or tool, not an inherent feature of particular political cultures. Scholars surmise that as traditional societies modernize and political parties take over the administrative machinery of the state, mass-level clientelism emerges to replace traditional patron-client relations. The mechanism is not well understood; it appears that local patron-client relations are incorporated into national party structures and, further, constitute the very basis of the national party. Party leaders replace local notables as the providers of access to necessary resources.

Clientelism is less likely to emerge where the civil service is backed by a coalition of political parties and other elites who support the autonomy of the state's bureaucracy. The question then becomes under what conditions does such a coalition emerge. The development of clientelism hinges on the nature of state-building in a particular polity. Some contend that differences in cultural practices affect whether an autonomous civil service can be created, others contend that structural factors, such as the nature of representative bodies, affect the outcome.

The effect of clientelism on economic growth and on political development are widely disputed. Some contend that clientelism increases the efficiency of economic exchange by obviating cumbersome regulations, others claim that it decreases efficiency by making transactions opaque and dependent on interpersonal networks that are costly to build and maintain. Some contend that clientelism is a phase that most countries pass through as they modernize, while still others argue, by contrast, that such a system slows or actually blocks modernization. Most agree clientelism is a hindrance to democracy, as patron-client relations give advantage to the party in power and privatize what should be public decisions regarding the distribution of resources.

closed economies

Further reading

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CAROLYN WARNER

CLIMATE CHANGE CONVENTION *see* global warming (UN Climate Change Convention)

closed economies

A closed economy has no links to the rest of the world and, in its most simple form, has no government either. In this form it can be represented by the following three equations:

$$(1) Y = C + I$$

$$(2) C = cY$$

$$(3) I = I^*$$

where Y = national income, C = consumption, and I = investment.

Equation (1) shows that national income is the sum of consumption and investment. Equation (2) shows that consumption is a share of national income. Equation (3) shows that investment is assumed to be autonomous – that is, independent of national income or consumption (both are endogenous variables).

A somewhat more complicated form of Equation (2), usually called the ‘consumption function’, can be constructed by including an autonomous component:

$$(2a) C = cY + C^*$$

In addition, the model can be made more complicated by including government expenditure and taxes. However, this does not change the essential characteristics of the model as a closed economy.

Savings (S) are defined as income not consumed: $S = Y - C$. Since it follows from Equation (1) that $Y - C = I$, savings are equal to investment: $S = I$. Lower savings, therefore, result in less investment and a lower national income. It should be noted, however, that a closed economy cannot be found anywhere in the real world. It is a model that allows one to discover the basic principles of national income and expenditure determination that apply to more realistic models of open economies (see OPEN ECONOMY).

M. PETER VAN DER HOEK

Coase theorem

In an influential 1960 article, Nobel laureate Ronald Coase argued that economic EFFICIENCY can be achieved even in the presence of EXTERNALITIES and without government intervention. Until the Coase theorem, economists argued that externalities had to be solved by some form of government intervention, typically a tax on an activity that caused external harm and a subsidy for an action that caused external good. Coase argued that the parties involved in the externality would find a solution to the problem themselves. The Coase theorem, as this claim is called, is best illustrated with an example.

Suppose that there are two firms: a paper factory which pumps waste into a river and a fishery downstream from the paper factory that uses the river water to raise fish. When the paper factory is operating at full capacity, effluent from the mill kills a certain number of fish in the fishery each month. Let us say that, as the factory reduces its production, it reduces its effluent and the fishery produces more fish. Let us also say that this happens at a decreasing rate – that is, more fish are saved by reducing production from 100 per cent to 99 per cent than are saved by reducing production from 99 per cent to 98 per cent, and so on.

First imagine that the paper mill is legally liable to compensate the fishery for the lost fish. The paper mill will reduce its production

to the point where the marginal value of the paper production (net of the costs of producing paper) equals the marginal cost of lost fish at the fishery. If there are still lost fish beyond that point, the mill will monetarily compensate the fishery because the value of the paper produced is higher than the value of the lost fish.

Now consider the case where the factory was not legally liable. Clearly in such a case the factory would have no independent incentive to compensate the fishery or cut production. However, and this is one of the main points of the Coase theorem, the fishery would have incentive to *pay* the factory to cut production. If the value of the lost fish exceeded the value of paper produced, the fishery would be able to pay the paper mill to cut its production back to where the marginal value of the produced paper (net of production costs) was equal to the marginal cost of the lost fish. Beyond that point, the fishery would not be able to profitably pay the paper mill to cut production and those fish would simply be lost to the fishery.

The legal liability of the case does not have an effect on its outcome. In either case, if the value of the fish is higher than the value of the paper, production is cut back and more fish are produced. If the value of the paper is higher than the value of the fish, more paper is produced and fewer fish are raised. The laws of liability do not matter for the economic efficiency – in both cases the solution is efficient. We may consider the case where the factory bears the costs of its pollution to be more ‘fair’ than the case where the fishery bears those costs, but they are equivalent in terms of economic efficiency.

The Coase theorem forced economists to ask the simple but important question: ‘When two actions conflict, which does society value more?’ In the above example, paper production could only be increased with a reduction in fish production, and vice-versa. Laws which would automatically make the paper plant reduce production could be inefficient, because perhaps society valued paper more than fish.

The Coase theorem is based on three crucial assumptions: (1) no transactions costs, (2)

perfect information and (3) enforceable property rights. If any of these features are missing, it may be costly for the two parties to the externality to reach an efficient compensation scheme, and the efficient solution might not be reached. The gains from the transaction between the paper mill and the fishery may be lost in costly bargaining between the two firms.

ROBERT KEOHANE used the Coase theorem to explain the functions of international institutions – as approximating to the conditions of the Coase theorem (see INSTITUTIONALISM, LIBERAL).

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MICHAEL J. GILLIGAN

Cobden, Richard (1804–65)

Richard Cobden was a Manchester cotton warehouseman, radical pamphleteer and politician. In his first pamphlet, ‘England, Ireland and America’ (1835), Cobden adumbrated what were to become his life’s concerns. In meeting the competitive challenge of the United States, British industry was hampered by protectionism and economic intervention on one hand and the fiscal burden of excessive military expenditure on the other. His elegant answer was to displace the hereditary aristocracy from their position of privilege in national life. Removing TARIFF protection from British cereals would reduce the living costs of industrial labourers, keep down wages and so help to maintain the competitiveness of British manufactured goods in world markets. But it would also hit the power of the aristocracy, both by reducing the agricultural rents on which they depended for their private incomes and by cutting the income the state derived from import duties, on which predominantly aristocratic governments had depended for the military expenditure entailed by their constant

interventions in European politics to maintain a supposed balance of power. Were the state to compensate for lost income by increasing direct taxation, this would merely complete a shift in relative power from the aristocracy to the middle class, since new tax-payers would be stung into closer scrutiny of public policy, bringing their superior organizational skills to bear through lobbying for liberal and pacific policies. A progressive curbing of aristocratic power would reveal the general and worldwide interest in free trade and create a powerful cosmopolitan lobby against future warfare.

Cobden pursued his campaign for free trade and international peace over the next quarter century as agitator, pamphleteer and parliamentarian. He was a leading member of the Anti-Corn Law League and had the satisfaction, in 1846, of voting as a radical member of the House of Commons to repeal the CORN LAWS. The Anglo-French (Cobden-Chevallier) commercial treaty of 1860, negotiated by Cobden on behalf of the Palmerston administration, marked a further step towards general free trade, since both parties extended the concessions agreed in the treaty to all their trading partners, with the consequence that a number of liberalizing bilateral treaties followed hard on its heels. Cobden reluctantly sided with the North in the American Civil War (1861–5), working assiduously to ease relations between Britain and the Union, and to clarify and develop international law affecting commerce in time of war in a manner that would severely limit the rights of belligerents to interfere with trade.

Towards the end of his life, Cobden's early optimism about the progressive role of the middling classes to which he belonged gave way to disillusion in the face of the willingness of British investors to finance the depredations of autocratic regimes by subscribing to their London loans and a growing tendency towards concentration of capital, producing a new oligarchy notable for its deference to the old, the 'toadies of a clod-pole aristocracy', as he called them (Morley, *Life*, i, 137).

CHARLES JONES

cobweb theorem

The cobweb theorem is used to describe the non-instantaneous adjustment to supply–demand equilibrium followed when there are delays in responses to changing conditions caused by the time required to produce goods. The delays can produce cyclic fluctuations in prices for the goods concerned.

A standard example is agricultural products, where producers often take production decisions many months before goods come to market. Referring to Figure 1, suppose that the price P_0 on the basis of which producers plan this year's output level Q_0 (perhaps the prices prevailing last year) turn out to be above this year's equilibrium level. This may be because relatively adverse weather conditions in some regions last year reduced total world output and inflated prices. Supply this year will then turn out to exceed demand and the price will fall to, say, P_1 . Planning output Q_1 for the following year on the basis of these lower prices, suppliers will subsequently tend to underproduce, leading to an increase in prices to P_2 .

This cyclic behaviour will continue, either until equilibrium is obtained or indefinitely or explosively, the particular outcome depending on the relative slopes of the (long-run) supply and demand curves. The case of convergence towards equilibrium is illustrated, and Figure 1 demonstrates the origin of the name 'cobweb'. This behaviour is somewhat idealized: in reality producers might hold stocks when prices are low for release in periods of underproduction

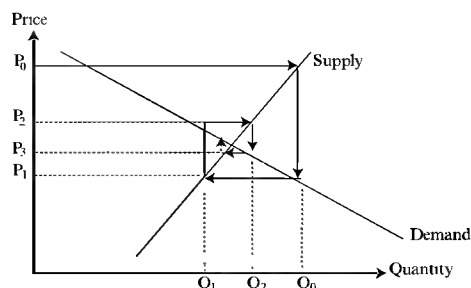


Figure 1 Cobweb with convergence towards equilibrium

and behave more flexibly in other ways. Nevertheless, oscillations in many commodity markets are observed in practice.

JOHN CLARK

coercion

The definition of 'coercion', like so many concepts in the social sciences, is a subject of debate. In general, however, it is a subset of POWER denoting a direct or indirect, raw or subtle exertion of force to achieve some objective. More specifically, it entails the use or the threat of the use of force to induce an action that would not have otherwise have been performed. From this perspective, coercive situations arise from interpersonal relations, from relations between classes or groups and from relations between states, although such relations are more commonly described in terms of the wider concept of power. The definition also suggests various types and dimensions of coercion. Types range from physical to psychological and the dimensions include moral, legal and philosophical.

Coercion raises moral and legal questions. Such questions draw attention to notions of responsibility and obligation, both of which arise from what some have called the 'voluntariness principle' (Wertheimer, 1987). This holds that individuals are responsible for their actions and that these responsibilities are binding to the extent that such actions are voluntary. The assumption is that individuals voluntarily engage in action and that any action that is involuntary not only encroaches on individual freedom, but it also strains the limits of accountability. There is therefore a need to establish the grounds of accountability. The question is whether or not, and to what extent, individuals can be held accountable for actions under coercive influences. Could a coerced promise, for example, be legally or morally binding? Can punishment be inflicted on a person for acting under coercion? Which actions are coercive and how can the validity of such claims be established?

Some of these issues have been raised in political theory. Liberal approaches (see LIBERALISM) emphasize the notion of individual freedom and responsibility as crucial, defining factors in coercion. In this sense, it is defined in relation to the STATE and is seen in terms of a division between consent and force. The state monopolizes force, the use of which is considered legitimate and rational. The state's legitimacy derives from an individual's acceptance of membership in a political community. By thus agreeing, individuals empower the state to maintain order. This arrangement is considered rational and its rationality arises from its instrumentality – that is, from the recognition by individuals that a constrained freedom with a state is far more beneficial than an unconstrained freedom without one. Coercion thus becomes a question of scale and it arises when a state, pursuing its legitimate objectives, uses force beyond a normally acceptable level. A typical example is the 'excessive' use of force on civilians. It also includes state actions that either impede or prevent the expression of individual freedom. Moreover, such actions could extend to the whole political community where state actions subvert rather than protect it. In any case, individual freedom, consent and the neutrality of the state are central to the definition of coercion from this perspective.

In contrast, Marxist political theory (see MARXISM–LENINISM) locates coercion centrally within the state. It views the state as the organized coercive power of one class over another. In agreement with liberal political theory, coercion is exercised in the *public* interest. Contra liberalism, however, its exercise in the public interest also obscures the *private* interests that it protects. Coercion is seen not just as the repressive activity of state agencies. Its appearance as physical force on the political level serves to mask its economic and generalized nature and roots. The coercion exercised by the state is not simply a question of force; it is rather a kind of power concentrated in the hands of the state, the most obvious expression of which is its open dimension. At the same time, where such power is not openly coercive,

it is generalized as consent representing the public interest. In this way, only the physical aspect of state coercion is obvious; less obvious, in fact hidden, are broader forms that present themselves as consent in the form of 'individual freedom' and 'state neutrality'. Coercion thus appears as generalized consent acting on behalf of society. In Marxism, coercion and consent are inextricably bound together, and cannot be understood at the level of political phenomena alone. Both must be grasped from their roots, in the process of capitalist production itself (see CAPITALISM).

What is the implication of these for the understanding of relations between nations in this era of 'GLOBALIZATION'? The collapse of Soviet SOCIALISM signals what many consider the triumph of liberal democracy. This is seen as strengthening the basis for exporting liberal democratic models, especially to peripheral countries. Thus, while AID had always depended on the economic and ideological interests of donors, such controls will be even stronger now. However, the UNEVEN DEVELOPMENT of capitalism suggests that the marginalization of peripheral countries will continue and that liberal reforms are unlikely to be sustained alongside intensifying economic crises. This will generate new conflicts and exacerbate others within and between nations. Coercion looks likely to intensify in the light of this scenario. Already, this pattern is noticeable in Africa and parts of South-East Asia. These conflicts and expansion in coercion would be limited not just to DEVELOPING COUNTRIES.

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MOHAMMAD J. KUNA

Cold War

The term 'Cold War' identifies the conflict between the United States and the Soviet Union that dominated international politics from the end of World War II until the dissolution of the Soviet Union in 1991.

Historiography of the Cold War has gone through three phases. The 'orthodox' or 'conservative school' stressed the culpability of the USSR, focusing in particular on the aggressiveness of Soviet foreign policy in the late 1940s. It differed, however, on the reasons for such aggressiveness, attributing it either to Russian imperial tradition or Marxist-Leninist ideology (see MARXISM-LENINISM). Later the 'revisionist school' put the blame on the United States, stressing either the 'imperialistic' impulse of its capitalist economy (see CAPITALISM), the 'MILITARY-INDUSTRIAL COMPLEX (MIC)' or the anti-communist ideology of the Truman administration. Finally, the 'neo-revisionist school' put forth a kind of synthesis that stressed the nature of the international system as a determinant of the conflict. The United States and the USSR were the only two SUPERPOWERS left to confront each other on the world scene at the end of World War II and were therefore bound to collide like 'two scorpions in a bottle'. It also saw the ideological differences and individual misperceptions that fed suspiciousness on both sides as reinforcing the propensity towards conflict, due to the bipolar nature of the international system.

After the end of World War II, the Soviet Union proceeded to consolidate its grip on Eastern Europe and exercise pressures on other

countries in southern Europe. This might have been primarily the result of security concerns, but was interpreted in the West as the beginning of Soviet expansionism. The United States responded with a doctrine of 'containment' that had both an economic and a military component. Economically, the United States extended aid to Turkey and Greece when they came under Soviet pressure, and then launched the MARSHALL PLAN to finance the process of European economic reconstruction. Militarily, the United States sponsored a number of alliances with an anti-Soviet function – the first and most important of them being the NORTH ATLANTIC TREATY ORGANIZATION (NATO) (1949). The Soviet Union, following the rearmament of West Germany and its inclusion into NATO, responded with the formation of the Warsaw Pact (1955). In 1953, 'containment' was replaced by the doctrine of 'roll-back': the West would not only halt the expansion of COMMUNISM, but also help liberate 'captive' nations. In Europe, however, the United States did not dare challenge the USSR in its own sphere of influence, as demonstrated by Western inaction in response to the Soviet invasion of Hungary in 1956 and of Czechoslovakia in 1968.

Geopolitical competition between the two superpowers took place primarily in Asia and Africa. Military and economic aid from the United States and the USSR flowed generously to various governments and rebel groups on these two continents. In the name of anti-communism, the United States often supported regimes with questionable democratic credentials, even right-wing dictatorships and fundamentalist Islamic groups, while the Soviet Union supported 'national liberation struggles' and any regime ready to declare itself socialist.

The two superpowers never confronted each other on the battlefield, but fought each other by proxy. Direct military intervention by the superpowers was rare. The United States led a military force – sanctioned by the UNITED NATIONS (UN) – on behalf of South Korea when North Korea tried to reunite the country by force (1950–3). It then directly intervened in the civil war in South Vietnam (1965–73). The

USSR intervened in the civil war in Afghanistan on behalf of the socialist lay government against fundamentalist Islamic rebel groups (1979–89).

The two superpowers came close to a direct confrontation, however, during a number of international crises. Besides those over Berlin in 1948–9 and 1961, and the Middle East crises of 1956, 1967 and 1973, the one that brought the world to the brink of nuclear disaster was the Cuban missile crisis of 1962. In an attempt to make up for its strategic inferiority, and ostensibly also to defend Fidel Castro's socialist revolution from a possible US invasion, the USSR placed a number of short- and medium-range nuclear missiles on this Caribbean island, only 90 miles off the coast of Florida. They were withdrawn after the United States threatened to destroy them and imposed a naval blockade on ships directed to Cuba.

The United States enjoyed nuclear monopoly until 1949. The successful testing of a nuclear device by the USSR created a widespread sense of insecurity in the United States that culminated in the communist witch-hunt led by Senator Joseph McCarthy. In the arms race that ensued, the United States maintained a strategic edge in the number of warheads, intercontinental bombers and submarine-launched intercontinental missiles (SLBMs), while the USSR retained superiority in conventional ground forces and acquired a lead in the number of intercontinental ballistic missiles (ICBMs) by 1969. By this time, however, each side possessed the capability to destroy the other regardless of who struck first. The maintenance of peace thus came to rest not so much on the system of collective security built around the UN, but on nuclear deterrence (or the 'balance of terror' as it was sometimes called). Deterrence rested on the equilibrium provided by Mutual Assured Destruction (or MAD) – that is, the knowledge that a first strike would be met with an inevitable retaliatory strike from the other side.

Détente (a period of reduced tensions and increased cooperation) characterized the Cold War in the 1970s. The United States, under President Richard Nixon and Secretary of

State Henry Kissinger, abandoned earlier anti-communist crusading in favour of sober balance-of-power politics. What was to be contained was no longer 'communism' but the USSR. They first improved relations with China (the Sino-Soviet relationship had steadily deteriorated since 1960) and then used trade and technology as incentives to extract concessions from the USSR in other fields. The Soviets embraced détente out of economic need and for fear that China might become too closely aligned with the West. To stabilize the deterrent balance, the two superpowers negotiated some important arms control treaties. The 1972 and 1979 Strategic Arms Limitation Treaties (SALT I and II) put numerical limits on the number of both warheads and delivery systems, and stipulated that the two superpowers would not build a nationwide anti-ballistic missile system. Although the US Senate did not ratify SALT II, both superpowers abided by its terms.

Throughout détente, however, neither the USSR nor the United States ceased trying to gain geopolitical advantages. The USSR intervened, often with the help of the Cubans, in the civil wars in Angola, Ethiopia and Afghanistan, and sponsored a coup in South Yemen. The United States, especially after the arrival of the Reagan administration, extended support to the anti-Soviet sides in Angola and Afghanistan, and intervened directly to topple the pro-Cuban government in the tiny Caribbean island of Grenada. It also organized the Nicaraguan 'Contras' to fight a guerrilla war against the socialist government of the Sandinistas. Claiming that the arms treaties of the 1970s had weakened US defence, the Reagan administration also embarked on an arms build-up. Besides new bombers and more accurate ICBMs and SLBMs, it also included the controversial STRATEGIC DEFENSE INITIATIVE (SDI) that aimed at building a total defence system against missiles and thus risked undermining deterrence and triggering a new arms race.

Things, however, began to change rapidly after Mikhail Gorbachev became leader of the USSR. He sought better relations with the

West in order to reduce the military's share of the USSR's budget and to concentrate on restructuring its ailing economy (see *PERESTROIKA*). To this end, Gorbachev sought new arms reduction agreements (the 1987 Intermediate Range Nuclear Forces (INF) treaty eliminated all intermediate range missiles), withdrew Soviet forces from Afghanistan and moved to reform the political system by making it more transparent (*glasnost*). Gorbachev's reforms (and goals) were limited, but they unleashed forces that he was not able to control. Within a brief period of time, Eastern European countries moved out of Moscow's orbit, the Berlin Wall (the biggest symbol of the Cold War) was taken down in 1989 and Germany was reunited in 1990. The following year, the Soviet Union itself disintegrated into its constituent republics and the Warsaw Pact was dissolved.

In so far as the Cold War was an ideological struggle between laissez-faire LIBERALISM and command-economy SOCIALISM, it can be said to be over. If the term is understood, however, as a political, economic and cultural struggle for power, the Cold War is simply going through a transitory phase. The US-led West might soon have to confront a more outward-looking China, perhaps in alliance with an economically revitalized Russia, or an Islamic world that has succumbed to the virus of religious fundamentalism.

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OSVALDO CROCI

collective action

The problem of collective action arises when individual pursuit of self-interest leads to collectively undesirable group outcomes. In such circumstances, groups fail to achieve common objectives that are in the interest of every member. Even if all NATION-STATES would be better off with a clean international environment, for example, each state has individual incentives to avoid pollution controls whose costs exceed the direct benefits they receive from reducing their own pollution. Such self-interested reasoning ignores the benefits that other states would receive from the pollution reduction. If all states reason this way – as individual RATIONALITY dictates they should – then all are worse off than if all had forgone their individually preferred behaviour in favour of collective action to reduce pollution. Other standard international examples include ‘free riding’ (see FREE RIDER PROBLEM) on alliances, trade protectionism, overfishing and underprovision of research. (Note that the problem can be defined in terms of either achieving group goods or avoiding group bads without changing the basic analysis.)

Resolution of collective action problems is often difficult because it requires linking state choices to collective rather than purely individual outcomes. While this can sometimes be

accomplished through decentralized arrangements, successful collective action often requires some greater form of institutionalization. Because of the substantive importance of collective action problems, and because of the richness of the analysis and the questions it raises about international governance, collective action theory underpins many important aspects of contemporary international relations (IR) theory.

Diversity of collective action problems

While the basic problem had been recognized earlier, Olson’s (1965) seminal formulation of the collective action problem, based on a model of PUBLIC GOODS, provides the standard case. The key to Olson’s model is the property of non-exclusion, whereby if the good (or some portion of it) is provided, then it is available for all to enjoy. This separates the benefits of the good from the costs of producing it, so that no one has an incentive to provide the good. The result is a collective action problem where all participants seek to free ride off the contributions of others, rather than contribute to production of the good.

Since very few circumstances approximate the pure public goods model, the strength of collective action analysis has been its somewhat loose application to a wide range of different circumstances – often grouped under the broad category of COLLECTIVE GOODS. These problems all share the same basic disjuncture of individual and collective incentives, but entail different specific combinations of essential properties that lead to sometimes divergent conclusions. In addition to public goods – which are both joint (that is, the good can be enjoyed by all) and non-excludable (that is, no one can be prevented from enjoying the good), important cases include club goods – which are excludable so that non-contributors can be prevented from enjoying the good, local public goods – which affect only actors in a certain geographic area or jurisdiction (and which may correspond to taxing or other capacities), and common pool resources – where exclusion is costly and the resource system (for example, a

fishery) is joint but individual resource units (for example, fish) are excludable through appropriation.

The PRISONERS' DILEMMA game is the simplest representation of a two-person collective action problem. The equilibrium outcome occurs when both sides follow their individual self-interest by not cooperating; the result is that neither cooperates and each is worse off than if both had cooperated, representing a failure of collective action. When the circumstance recurs through time, then cooperation can be supported through reciprocity if both sides contribute to the collective action contingent on the other's contribution. Unfortunately, this solution breaks down with larger numbers of actors whenever contingent punishment of a deviator cannot be implemented without upsetting the general cooperative activities. Alternatively, if enforcement is organized separately from contributions to collective action, then a second-order collective action problem arises with regard to who should bear the costs of enforcement.

Generalizations from collective action theory

The success of collective action theory lies in its general and somewhat abstract formulation. The underlying public goods model allows for rigorous and surprising deductions that have stimulated much research, both empirically and analytically. Although the deductive implications are subject to qualification under different specifications of the collective action problem, the generality of these claims has provided a valuable starting point for much analysis. Moreover, the richness of the public goods concepts (and of the other factors that affect collective action) has allowed the model to be applied to a wide range of circumstances.

The first claim of collective action theory, noted above, is that groups may fail to achieve objectives that are in the interest of all their members. A closely related second claim is that larger groups are more likely to fail to meet their objectives than smaller ones. The intuition is that as the number of actors (n) increases, the

relative importance and visibility of each individual's contribution decreases, so that each individual state believes that its non-participation will not affect the willingness of others to participate. The result is that individual incentives to free ride by not contributing to collective action will be more prevalent in larger groups. This tendency is reinforced by the increasing transaction and organizational costs of collective action in larger groups. In addition, certain characteristics that may be empirically associated with small groups – including better information and communication, closer connections on other issues, and tighter cultural or social bonds – are less likely to be present to help overcome collective action problems in large groups. While the strategic argument regarding the relation of the individual to the group is the mainspring of collective action theory, these other factors provide key contextual factors that also change with n .

Despite its general applicability, the claim that larger groups are more likely to fail requires qualification:

- 1 If contributions to the activity are continuous, then in a wide variety of cases (for example, normal goods) total contributions to collective action will actually increase with n . The basic claim is restored, however, if failure is defined in terms of the shortfall from the optimal level of provision, since the optimum collective provision rises faster with n than does actual provision.
- 2 The impact of increasing group-size depends on the specific form of interdependence between actors. For example, collective action that becomes progressively more successful as each additional state contributes (for example, reducing pollution) will be very different from situations where the defection of a few, or even a single rogue state, might upset the group effort (for example, non-proliferation arrangements).
- 3 Group-size can also be defined in different ways. In addition to defining it as the overall number n affected by the collective action, an important alternative is the minimum num-

ber k who can benefit from collective action among themselves. Often a large n -group contains a smaller k -group who are better positioned to achieve collective action.

A closely related third claim of the theory is that collective action is promoted by asymmetry within groups. Olson describes a group as 'privileged' if one of its members derives sufficient individual benefit from the good that it is willing to provide it unilaterally ($k = 1$). This situation leads to the striking corollary that the 'small exploit the large', since the large actor bears the cost of collective action while the small actors free ride. This privileged group argument has played a central role in IR theory as the fundamental logic of HEGEMONIC STABILITY THEORY. The argument is that dominant countries – Britain in the mid- to late nineteenth century and the United States after World War II – had both the capacity and the self-interest to provide stable international monetary and trade regimes from which all countries benefited. A refinement is to view asymmetry as creating smaller k -groups, so that a small number of states can gain from collective action even if no state can individually. Small groups like, say, the GROUP OF 7 (G-7) are better positioned to achieve collective action than a group of nearly 200 states would be if they all had to act together. The generalized benefits of this collective good depend, however, on the assumption that all states share a common interest in the particular action chosen.

Achieving collective action

The pervasive importance of collective action problems has stimulated great interest in how they can be overcome. Strictly decentralized solutions are effective only in certain situations. On-going relations through time – especially supplemented by horizontal linkage across issues – can support cooperation through strategies of reciprocity. These can be powerfully effective in two-actor settings, or in large- n settings where interactions can be decomposed to bilateral relations. But decen-

tralized solutions degrade rapidly as n increases, especially in noisy environments and where the actors are diverse, and so do not offer a general solution. In other special cases – such as where the project depends on every contribution (weakest link technology), with threshold effects or with small cooperating k -groups – the prospect that collective action depends on each and every contributor may provide self-enforcement. Even in these cases, however, collective action requires that actors have good information about each others' behaviour. Here decentralized solutions can be profitably augmented by institutional arrangements that improve information.

Centralized arrangements provide an alternative solution to collective action problems. If non-contributors can be excluded from benefiting from the good – or taxed for their contribution – then collective action can be promoted through either market or political institutions. For example, the market is an institutional setting in which property rights are centrally enforced to ensure that those who enjoy goods must contribute to their production. Alternatively, contributions to collective action can be mandated directly by a central political authority and, in a democratic system, a proposal to tax everyone to support collective action will be a majority Condorcet winner. But such centralized arrangements are typically imperfect and cannot achieve optimal results except in special situations. Problems encountered include the suboptimality entailed in exclusion when goods are joint, and incentives to misrepresent demand for collective action if that affects tax shares. Theoretical solutions to these problems, including 'demand-revealing processes', are not fully practical even where centralized authority is available.

The alternative of overcoming collective action problems through central governance is normally seen as unavailable under international anarchy (see ANARCHY, INTERNATIONAL). This conclusion is misleading both in overstating what is needed in terms of international governance and in understating what is possible in international anarchy. A simple example is the resolution of international collective

collective goods

action problems through the creation of property rights to enable otherwise decentralized solutions. Recognition of coastal fisheries, for example, allows states to manage conservation of non-migratory fish species directly. Other forms of exclusion may provide a means to facilitate decentralized agreements, if benefits can be restricted to 'clubs' of states. Membership rules of international organizations might seem to perform this function, although few of them are strongly exclusive in this fashion. Alternatively, regional groupings either might provide a pre-existing organizational structure upon which to 'piggy-back' a solution of collective action problems, or in some cases may provide boundaries of exclusions as with local public goods. Finally, cooperation among smaller regional groupings may be easier to achieve and potentially provide the building blocks for a broader, cross-regional collective action.

See also:

externalities

Reference and further reading

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DUNCAN SNIDAL

collective goods

The term 'collective goods' describes a large category of situations where members of a group benefit together from some activity; they are thus closely tied to the analysis of COLLECTIVE ACTION. Most discussions focus on the consumption side and the property of 'non-exclusion', whereby if a good is provided to one actor it is necessarily available to a wider range of actors. Although it is often taken as an inherent or technological property of the good, non-exclusion is typically also a function of political institutions including PROPERTY RIGHTS and membership rules that define the beneficiaries of the good (Snidal, 1979).

Collective provision is sometimes misleadingly treated as a defining feature of collective goods. Certainly, many collective goods (such as motorways and public safety) are provided by the STATE at the domestic level, while international organizations aspire to perform similar functions at the international level. Moreover, some goods are collective primarily in the form of their provision (for example, multilateral redistributive aid programmes). But the most interesting analytic work has focused on showing how collective goods can be provided without strong centralized government.

The most significant question is, then: What alternative institutional arrangements are necessary and appropriate for the provision of collective goods? Although the generality of the concept is useful for identifying similarities across different problems, its definition is too vague a basis to enable precise analysis to answer these GOVERNANCE questions. Fortunately, the literature has become progressively more rigorous in identifying distinct types of collective goods for detailed analysis. Several categories are of special note.

The most famous case is the 'PUBLIC GOOD', where benefits are non-exclusive and joint. Unless the number of actors is small, public good provision will typically be suboptimal. This provides the most compelling case for centralized provision and suggests that collective goods will not be provided at the international level except in special circumstances. The classic example is the public good of 'international order', which (according to HEGEMONIC STABILITY THEORY) will only be provided if a single dominant actor has sufficient interest to provide it unilaterally.

A second case is the 'club good', where benefits are restricted to members who contribute to the good. Examples include alliances and trading blocs. A related variant is the 'local public good' where benefits accrue only to certain actors (often geographically determined). Such smaller groups, especially if they can threaten exclusion, can promote contributions to the collective good. Regional arrangements offer an example of club goods and arguably could be building blocks to a broader multilateral cooperation based on the logic of federation in collective action.

A third case is the 'common pool resource', where exclusion is costly, the collective good is private at a point in time (that is, what I appropriate, you can't have), but the resource system itself is public over time (that is, if the stock is maintained over time it is available to both of us). Standard examples include renewable resources such as international fisheries, but the model applies a much wider range of problems (Ostrom, 1990).

Thus collective goods cover a rich diversity of problems that face states internationally. Within this broad range, a set of more specific cases leads to sufficiently clear models for tight analysis. While many of their conclusions contain similarities, these situations also vary sharply in ways that can be connected through their analytic assumptions to the real world.

See also:

free rider problem; paradox(es) of rationality; rational choice

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DUNCAN SNIDAL

Colombo Plan

The Colombo Plan, conceived at a meeting of Commonwealth foreign ministers meeting in Colombo in January 1950, was a donor coordination mechanism for South and South-East Asian countries. At this first meeting it was agreed that Commonwealth countries in the area should draw up development programmes for a six-year period from July 1951 and a consultative committee was formed (whose original members were Australia, Canada, Ceylon (now Sri Lanka), Pakistan and the United Kingdom) which produced the Colombo Plan for Cooperative Economic Development in South and South-East Asia. The initiative did not remain restricted to the Commonwealth, as other countries in the region joined the committee (and the Coordinating Council for Technical Cooperation, based in Colombo) during the 1950s, as did the United States and the United Nations.

The plan was clearly inspired by the MARSHALL PLAN of US assistance to Europe: each plan was to be implemented by a joint committee of recipients and donors, which has not been the case with most aid coordination bodies. However, the level and type of aid were

very different. First, during the Marshall Plan the United States transferred about 2 per cent of its GROSS NATIONAL PRODUCT (GNP) each year to Europe, compared with the less than 0.5 per cent aid donors give to all developing countries. Second, while the Marshall Plan was primarily programme aid, the Colombo Plan was almost exclusively technical assistance. A final difference is that some Colombo Plan recipients were also donors, albeit on a limited scale (for example, India and Malaysia).

During the first three decades of its existence, the Colombo Plan provided over 350,000 scholarships for overseas study, but by the 1970s was being eclipsed by other bodies such as the UNITED NATIONS DEVELOPMENT PROGRAMME (UNDP) and the ASIAN DEVELOPMENT BANK (ADB). Attempts to close down the organization towards the late 1980s were however stopped by new injections of Japanese and Korean money, in an attempt to revitalize the organization as a channel for disseminating the lessons of East Asian success throughout the rest of Asia.

HOWARD WHITE

colonialism

Colonialism was (and is) such a historically and geographically diverse practice and experience, that only a very broad definition is possible. In essence, colonialism involves establishing a population within a foreign country for the purpose of maintaining power over peoples, goods and territories, while keeping political links with the mother country. Although there are many different forms of colonialism, they all involve an encounter, and often a violent one, with the existing inhabitants of the colonized area. To one extent or other, colonialism results in the physical, economic and/or social displacement of the colonized peoples and civilizations. But this common factor apart, it is important to recognize the heterogeneity of colonialism and colonial experiences (on all sides). A shortcoming of many major theories of colonialism

is their inability to account for its diversity in space and time – a problem that will dog any attempt (including this one) to summarize or simplify colonialism.

Before moving on to consider various aspects of colonialism in more detail, it is worth briefly mentioning IMPERIALISM, as the two terms are often used interchangeably. There is no hard and fast division between imperialism and colonialism, particularly as both terms have shifted in meaning and associations over time. However, most commentators agree (somewhat tautologically) that imperialism represents a more self-conscious desire to conquer and control an empire. This may involve territorial conquest, but can also be used to refer to the economic exploitation or even cultural domination of one country by another without necessarily engaging in formal rule over that country. Colonialism, on the other hand, always involves settlement in and rule of a foreign territory, whether it is associated with an empire or not.

The practice of colonialism stretches back throughout human history and has always been brutal, exploitative, complex and creative. Some colonial possessions have covered vast territories, such as those of the Roman, Inca, Aztec, Vijaynagara, Chinese, Moghul and Ottoman Empires. Modern European colonialism (which is usually taken to date from the late fifteenth century onwards) shared many features with these preceding colonial regimes, but it was also unique in certain respects. First, European colonialism was far more extensive than any of its non-European counterparts. By the 1930s, colonies and ex-colonies accounted for 84.6 per cent of the world's land surface, with the only exceptions to formal European rule being (what are today) Thailand, China, Tibet, Japan, Mongolia, Afghanistan, Iran and parts of Saudi Arabia. Second, a more qualitative difference between European and previous colonial regimes lies in its relationship to the expansion of the capitalist world economy. European colonialism not only drained wealth and goods from the colonies, it drew them into a world system of capitalist relations of exchange and production which

required a fundamental restructuring of their economies and societies. In this respect, European colonialism has been described as acting as 'mid-wife' to the development of capitalism.

Why did the European states become geopolitically dominant in this period? Various reasons have been suggested, all of which probably played a part. They include technological achievements (especially in shipping, war and the art of navigation), political competition within Europe, the economic compulsions associated with the INDUSTRIAL REVOLUTION (notably the demand for raw materials and for markets), and luck or chance. Another theory, which was once pervasive but is now thoroughly and rightly discredited, was that of white racial superiority. But we must be careful not to theorize solely from 'Europe out', as events and decisions elsewhere were also critical. For example, between 1405 and 1433, the Chinese Admiral Cheng-ho undertook several extensive voyages, some reaching as far as the Red Sea and East African coast. If the Chinese had decided to pursue trade and/or colonial domination following these voyages, the world today might be a very different place, especially given their maritime, scientific and technological achievements, which were at the time equal (if not superior) to those of contemporary Europe. However, the Ming rulers decided to close down external links and isolate China, and banned these major voyages. Whatever the causes of Europe's rise to dominance, it was certainly not inevitable, but rather one of many possible outcomes given the state of the world in 1400.

A brief history of modern European colonialism

The beginnings of modern European colonialism can be traced to the Spanish conquest of islands in the Caribbean in the late fifteenth century and the following expansion into Central, South and North America. The explorers and *conquistadores*, and later the missionaries, settlers and traders, were driven by a combination of desires for gold, glory and Christian souls. Portugal was Spain's main rival

in this hemisphere and rapidly made inroads into modern-day Brazil. An early landmark in European colonial history was the Treaty of Tordesillas in 1494, in which Pope Alexander VI sought to settle the competition between Portugal and Spain in the New World by ceding to Portugal all the territories east of the 'line' along 48° longitude and to Spain all that was west of that line. (The fact that they would meet up later in South-East Asia was not anticipated, as this settlement was made on the basis of a flat earth.)

Colonialism in the Caribbean and Latin America was particularly devastating. Indigenous populations were decimated or even completely wiped out by a combination of disease, warfare, impoverishment, brutality and overwork. Between 1492 and 1650, the population of Central and South America is estimated to have fallen to between one-tenth and one-twentieth of its former level. Precious metals, especially silver, were extensively mined and sent back to Europe, while the region's plantations, *latifundia* and *haciendas* supplied fruit, sugar, tobacco and coffee to the European markets. As the local population declined, the demand for labour was met by slaves from Africa, and between 1500 and 1870 an estimated ten million slaves were shipped over the Atlantic. Most other aspects of the economy stagnated and, although much of Latin and South America achieved independence relatively early (for example Mexico and Peru in 1821, Brazil in 1822), it retained this dependent position in the capitalist world economy. This meant that, even after formal independence, much of Latin America continued to export raw materials and primary products overseas (which tended to be subject to declining TERMS OF TRADE) and import relatively expensive manufactured products from abroad. Thus it maintained the pattern of exchange that was characteristic of colonial economies.

Further south, in Argentina, Chile and southern Brazil, a slightly different colonial pattern emerged, which was marked by higher rates of urbanization, industrialization and investment in infrastructure. The main reason

for this was the development of settler colonialism, whereby Europeans arrived in large numbers to farm the land (as they also did in South and East Africa, Australia, New Zealand, Canada and the United States – see below). Settler colonialism contrasts with the pattern of colonial rule usually found in more tropical areas (such as the East Indies and West Africa), where very often a relatively small number of Europeans occupied the key positions in government, trade, the military and sometimes agricultural estates, but tended not to farm directly themselves. However, the economies of Argentina, Chile and southern Brazil, like other settler colonies, were still strongly oriented towards supplying overseas markets.

In the 'Old World' (Africa and Asia), European colonialism was preceded by centuries of contact through fishing expeditions, exploration, crusades, war and, above all, trade. For most of this period, Europeans were the equals of the other traders they met, and subordinates to the rulers with whom they negotiated. What drove the shift from trade relations to colonization was the increasing competition between the expanding European powers from about the sixteenth century onwards. As merchants from Britain, Holland and later France started to compete more directly for both raw materials and access to markets, it became increasingly important to secure monopolistic territorial control over former trading zones. Wars were fought in and outside Europe as competition between merchants escalated into armed conflict between the industrializing nations. By the late sixteenth century, Spain and Portugal had been superseded as the main agents of European colonial expansion as the northern European countries started to industrialize and expand their trading and territorial interests, especially in North America and Asia. Britain and Holland were the first countries to industrialize and were also the most dominant trading nations at this early stage. Britain eventually moved into the lead after a series of Anglo-Dutch Wars between 1652 and 1678, and following British consolidation of power

through the Act of Union between England and Scotland in 1707. Over the next two centuries, the British economy in particular was to act as an engine of world change. It did not simply increase the volume of global trade, but effectively established a world market which even drew in the regions outside formal European control (such as China).

The shift from trade to colonialism can be seen particularly clearly in Asia. The spices grown in this region were of enormous value back in Europe, where they added much needed flavour to an otherwise monotonous diet (especially in winter, when food was either salted or pickled). The Portuguese were the first to make colonial inroads as they sought to wrest control from Venetian and Arab traders. They extended their trading connections throughout the region, but were eventually supplanted by the more powerful Dutch, who (through the government-backed Dutch East India Company) largely gained control of the spice trade by 1616. The focus of European activity in South-East Asia in the seventeenth and eighteenth centuries remained securing spice supplies, trading routes and ports, rather than extending territorial conquests. However, in the nineteenth century (especially between 1825 and 1870) a number of factors led to the significant expansion of formal colonization, including Europe's increasing demand for raw materials, the desire to acquire overseas markets, and improved transport (through technological developments and through the opening of the Suez Canal in 1869). This set in motion a vast restructuring of the South-East Asian economy, which entailed massive forest clearance in order to produce more rice, establish rubber and coffee plantations, and extract timber and minerals, especially tin.

To go back a couple of centuries, after losing out to the Dutch in South-East Asia, the British had turned to South Asia. Here their main rivals were France and, to a lesser extent, Portugal. Aided by the internal weaknesses and eventual collapse of the Moghul Empire, France and Britain fought over India, with Britain gaining the upper hand in the decisive Battle of Plassey in 1757. The looting that

followed this victory nearly destroyed the East India Company by wiping out its productive base in India, prompting the British government to bring it under state regulation in 1773. Thus, just as the British were losing their colonial possessions in North America (during the War of Independence, 1775–83), they were substantially adding to them in India. One reason for British interest in India was to produce commodities that could be traded with the Chinese for their teas, silks and spices. However, the Chinese preferred bullion – a state of affairs that clearly was not favourable to the Europeans. The OPIUM WARS of the mid-nineteenth century resolved this by forcing trade agreements on the Chinese, and establishing protection for British and other traders.

Back in India, it was some time before the merchants and soldiers of the East India Company began to move inland and away from the key cities of Madras, Bombay and Calcutta, and to take a more direct hand in the growing of opium, tea, cotton, jute and indigo. Formal colonial rule was only extended over India after the 1857 Mutiny (or First War of Independence – neither term is especially satisfactory), when the Crown stepped in and took control from the East India Company. Queen Victoria was declared Empress of India in 1877. By the time of Indian independence, in 1947, Britain directly ruled two-thirds of this massive subcontinent and indirectly ruled (through negotiations and treaties) the 562 princely states that made up the other third. India was central to the nineteenth- and twentieth-century ‘superpower’ rivalry between Russia and Britain (known as the ‘Great Game’), underlining its geopolitical importance as a pivotal colonial possession.

The last continent to experience wide-scale colonization was Africa. Trade along the African coast existed centuries before colonization, but beyond the ports most of inland Africa remained the ‘Dark Continent’ that alternatively thrilled and terrified European imaginations. As late as 1880, only a few coastal areas of Africa were under direct European control – parts of Senegal, the southern Cape, patches of the east and west

coasts, and much of the Mediterranean rim. But by 1914 practically the entire continent had been divided up between seven European powers – Belgium, Britain, France, Germany, Italy, Portugal and Spain (the exceptions were Abyssinia, now Ethiopia, and Liberia). The reasons for this ‘delay’ included the high death-rate among Europeans, especially in tropical West Africa (the discovery of quinine was an important event in this respect), and the perception of Africa as relatively poor in resources. The extraction of its most valuable ‘resource’, slaves, had in the past been brokered by Arab traders and local rulers and warlords, and had not necessitated European penetration of the continent. The main reason for the vast expansion of formal colonial possessions in Africa between 1880 and 1920 was the depression in Europe at the end of the nineteenth century. Much of the ‘scramble for Africa’ originated in the growing economic and political competition between the European powers that this depression helped prompt, and in the growing sense of nationalism with which this was associated. At the 1884–5 Congress of Berlin, the European powers agreed to cooperate with each other and divide up Africa into respective zones of influence. The straight-line borders of parts of Africa still today bear witness to this extraordinary pact, in which considerations of pre-existing political territories or cultural and linguistic ties were ignored and the continent divided up like booty.

Germany was united only in 1871, and Chancellor Bismarck was particularly keen to enter the colonial race before the remaining territories were conquered by its older rivals. This desire for military and national prestige underpinned the vision of a new German Empire and encouraged the acquisition of several territories in west, south-west and east Africa, as well as in the Pacific and north-east New Guinea. The geostrategic nature of colonization in many parts of Africa can be seen in Germany’s annexation of what is now mainland Tanzania, which was partly aimed at disrupting British plans to establish a Cape to (Mediterranean) Coast railway line. Italy also

joined the colonial race rather late in the day, after unifying in 1870. It had to be content with mopping up in north Africa, finally subduing Libya and Ethiopia by deploying even more than usually brutal tactics (including the use of mustard gas). Another relatively 'late' colonizer was Japan, which over the late nineteenth and twentieth centuries conquered parts of China, South-East Asia and the Pacific, primarily in order to secure unrestricted access to raw materials. It tended towards extremely harsh centralized rule from Tokyo.

Australia and New Zealand provide rather different examples of colonialism in a number of respects, not least by becoming colonizers before they became independent themselves. They were settled originally by convicts and the military, and later by growing numbers of more 'orthodox' shopkeepers, farmers and artisans, especially after the discovery of gold. The scattered and relatively small aboriginal populations that the colonizers encountered were killed or subjugated, with the survivors officially remaining second-class citizens until well into the second half of the twentieth century. At the turn of the twentieth century, British (now Papua) New Guinea was given over to Australian rule, as were the Admiralty, Solomon and Bismarck Islands. New Zealand administered a number of island territories, the most important of which was Western Samoa. Colonialism in the Arab world was also unique in many ways. Until the end of World War I, most of the Middle East remained under the control of the Ottoman Empire. This was then divided up between Britain and France, both of which countries sought to control these territories through the intermediary rule of sympathetic local dynasties.

Finally, the United States is more usually associated with NEO-COLONIALISM and, for ideological and historical reasons (notably its part in the pressuring the European nations to decolonize after World War II), the US has assiduously resisted the label of a colonizer. Nevertheless, its early history represented just that, as colonizers pushed north, south and west, exterminating and displacing the local population. The United States also has colo-

nial links with Alaska, Cuba, Guam, Hawaii, the Philippines, Puerto Rico and the US Virgin Islands and Samoa.

Colonial ideologies of rule

A number of commentators point to the anxiety and ambiguity that accompanied debates within the European nations on the goals and effects of colonialism, both for themselves and for their colonies. Not infrequently there was a sense of 'muddling along' without a strongly defined sense of purpose or direction. There were also sharp arguments and conflicts about the ethics, economic (dis)advantages and geopolitical strengths/weaknesses of maintaining colonial dependencies. Bearing this uncertainty in mind (and the different opinions on colonialism that existed among Europeans), a number of broad generalizations can be made about the ideologies of rule that underpinned colonialism by the different European nations.

British colonialism aimed theoretically at eventual self-determination for its colonial subjects. This was a 'civilizing mission', preparing the natives for self-rule – even if such autonomy was reckoned to be centuries away given the 'backwardness' of the colonized populations. Paradoxically, this was usually allied with a preference for 'indirect rule', under which local customs and rules were minimally interfered with (except where it was deemed especially barbarous, such as the burning of widows in India). The experience of the uprising in India in 1857, which was widely interpreted as being the result of cultural meddling and poor administration by the East India Company (rather than as a result of economic exploitation), strengthened the British belief in indirect rule, a lesson that was carried with them in later colonial conquests in Africa. That said, in colonies where there was a larger settler population there tended to be a more interventionist stance in local politics and culture.

In contrast to this, French colonialism was influenced by the revolutionary principle of egalitarianism and the politics of assimilation. Although colonial peoples might be backward

and primitive, 'natives' were expected to assimilate French culture and language, and eventually become full French citizens. In practice, racist relations dominated cultural interactions and the economic compulsions of the core were prioritized over the development of the periphery. Several commentators note that French colonialism was often marked by more violence than British colonialism. In Portuguese colonies, only a small elite were permitted to attain the status of *assimilados*, theoretically implying full Portuguese citizenship. Belgian colonialism, on the other hand, was far more paternalistic and stultifying, and Belgian colonial subjects were offered no possibility of advancement. Indeed, in the Congo (which was once the personal possession of King Leopold II) not even the European settlers or administrators in the region possessed any political rights or voice in the ruling of the colony, never mind the indigenous population. All decisions were taken back in Brussels, contributing to the near feudal condition of Congo at independence and laying the foundations for many of the post-colonial problems with which it has had to deal.

Central to all of these differing ideologies of rule were the cultural assumptions that grew to 'justify' the colonial rule of Europeans over other peoples. The political economy of colonialism cannot be understood without reference to these cultural beliefs and the larger discourse of Orientalism. By coming to view non-Europeans as backward, primitive, childish and irrational (whether because of their supposedly low cranial capacity and inability to reason – as was argued to be the case with Africans – or because of their degradation from earlier civilizations thousands of years before – as was supposedly the case with Indian Hindus), colonization could be legitimated as the 'white man's burden'. These beliefs were ridden with pseudo-Darwinian concepts of survival of the fittest and environmental determinism, which helped stimulate a vast 'science' of racial difference. As might be expected from the discussion above, these beliefs were diverse, contested and changed over time, and post-

colonial studies now provide one of the most interesting and challenging areas of scholarship in the arts and social sciences.

The impact of colonialism

It is clear that neither the past nor the present world economy can be understood without placing at the centre of the debate the fact of 500 years of European colonialism. The period between 1870 and 1914, in particular, witnessed not only the significant expansion of colonial possessions, but also the deepening and intensification of the global division of labour. Colonial economies were forced into the yet more specialized production of raw materials and food products, while the colonizing nations specialized in manufactured goods for home consumption and for export. Human and natural resources were appropriated from the colonies and the manufactured goods and products returned and sold to them. In 1830, for example, three-quarters of Britain's total cotton exports went to its colonies in Africa, India and the West Indies. By manipulating the terms of trade to suit metropolitan interests and hampering or obliterating indigenous competition (by, for example, discriminating against and systematically deindustrializing India's textile sector) colonies could act as extremely valuable monopoly markets for the colonizing powers. No area of the globe was unaffected by this profound reshaping of the world economy, the effects and legacies of which continue to resonate throughout contemporary issues in political economy. However, the precise impact of colonialism for different areas and peoples remains contested.

For many Marxist writers, colonialism was seen simply as a tool of capitalism. In connivance with indigenous *COMPRADOR* groups of 'lumpenbourgeoisie', the European nations had systematically exploited the colonized nations, dividing the world into the developed and the underdeveloped, core and periphery. But there the Marxist camp splits. For many post-war neo-Marxist writers (or *dependistas*), such as ANDRE GUNDER FRANK, Samir Amin and IMMANUEL WALLERSTEIN, the key to

development was therefore to disengage from the capitalist world economy (see NEO-MARXISM). Frank argued that the peripheral nations should break away and construct autonomous socialist states in order to smash the vicious circle of dependency and underdevelopment. Building on the work of earlier *dependistas*, Wallerstein's WORLD-SYSTEMS THEORY postulated a single capitalist world system which had existed ever since the early sixteenth century. The emergence of developed and underdeveloped countries can be explained through their unequal incorporation within this world system (through colonialism) and its post-colonial perpetuation through unequal trade and continuing exploitation of the periphery by the core. But for other more 'classical' Marxist theorists, such as BILL WARREN, colonialism was a necessary evil *because* of its relationship with the expanding capitalist world economy. The penetration and eventual domination of capitalist relations of production were, in this argument, prerequisites for the proletarianization of the masses and thus for the conditions which would prompt revolution against the bourgeoisie. Such a revolution was in turn the necessary precursor to the ultimate goal of establishing a socialist state. The exploitation of the colonies was thus rather unsympathetically shrugged aside as an inevitable part of the manifest destiny of history, as was their present exploitation through systemic inequality in the capitalist world system. For all of the problems with Marxian theories of development, many anti-colonial activists found inspiration in Marx's writings on the dehumanizing and alienating effects of COMMODITY FETISHISM, and in his appeals for a revolutionary response to EXPLOITATION. However much of Marx's writings on class sits uncomfortably with other identities, notably race and gender, and many post-colonial critics have found a Marxian analysis of colonialism (and post-colonialism) significantly wanting in this respect.

In contrast to these views of colonialism as unambiguously exploitative (whether for better or worse) are those of the apologists for colonialism. D.K. Fieldhouse, for example, has tried to demonstrate the benefits of

colonial order, investment and infrastructure development on one hand, and the limited profits that colonial possessions returned to the core on the other. In Britain, both Gladstone and Disraeli, for example, thought that the colonies were a burden and that they drained, rather than added to, the British Treasury. Others stress the civilizing mission of colonialism; even if it was flawed, they argue, it was well intentioned. Lord Lugard's 'dual mandate', written in 1922, can be cited as an example of the genuine desire to improve conditions for Britain's colonial subjects. Lugard argued that the task of colonizers was to promote industrial and commercial progress in the colonies for the colonies, not just to enrich themselves. Some historians also argue that the weaknesses and underdevelopment of the colonies (and now of post-colonial economies) resulted from the 'absent-minded' or *ad hoc* nature of much colonial expansion and rule, and the unforeseen problems of their policies – not from deliberate underdevelopment. Whatever the shortcomings of these analyses (and these are substantial in places), they do quite rightly suggest that the economics and politics of colonialism were not always clear.

One of the most thoughtful accounts of colonialism can be found in Anne Phillips' (1989) discussion of British colonial policy in West Africa. She asks why did colonialism in West Africa serve the interests of capitalism so badly? After eighty years of European rule, direct investment remained low and continued to be dominated by public finances rather than private investment. At decolonization, most African economies emerged without the necessary bases for self-sustaining capitalist growth and were clearly marginalized within the world economy. Phillips points to the paradox of British officials defending pre-capitalist formations (societies, cultural practices and 'traditional' modes of production) and, on occasions, positively opposing commercial exploitation and industrial activity. She suggests that this was the result not just of a colonial officer 'type' or a belief in the benign mission to civilize and protect native peoples, but a pragmatic response to the practicalities of the

local situation and nature of the colonial relationship in west Africa. The coercion and cruelty associated with colonialism in Africa dispels the myth of benign and paternalistic rule, but at the same time the evidence does not fully support Marxist arguments about the dominance of capitalist relations in ensuring the continuing underdevelopment of the colonies.

Conclusion

There remain a small number of colonial territories around the world today, but the era of formal European colonialism is now largely over. Even so, the political, economic, cultural and environmental legacies of colonialism continue to shape the world around us today, ranging from the sporting profiles of India and Pakistan to the Indonesian restaurants of Amsterdam and 'curry houses' of the United Kingdom, from the gross under-representation of Southern nations in world decision-making bodies to the genocide in Rwanda. The study of different colonial experiences is, therefore, an essential basis for any understanding of contemporary political economy.

See also:

Cold War; decolonization; dependency theory; Non-Aligned Movement (NAM)

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colonialism and the need for careful scholarship in studying it. Of particular interest are the (often strained) relationships between different levels of the colonial hierarchy, from the British Government to the lowest colonial officer, and the ways in which colonial policies shaped and were shaped by local conditions.

EMMA MAWDSLEY

colonialism, internal

The concept of internal colonialism was only systematically developed in the 1960s, having been previously employed in a haphazard and sporadic manner. Terms like class, ETHNICITY, rural urban and regional relationships were found wanting when analysing the distinctive relations of exploitation and domination in DEVELOPING COUNTRIES. The concept of internal colonialism was much influenced by theories of imperialism and colonialism, but it was the national liberation struggles and the decolonization process of the post-war period which gave rise to the modern use of the term. After independence the persistent poverty and exploitation in developing countries could no longer be fully blamed on imperialist states. Thus the notion of domination and exploitation of indigenous inhabitants by indigenous inhabitants emerged. Parallels began to be drawn between the former external colonial relationships and the new internal relationships of domination and exploitation. Colonialism is then seen as an intra-national phenomenon, as well as an international one. Originally, internal colonialism is part of and is intimately linked to external colonialism, that is imperialism; later internal factors gain increasing weight in the perpetuation of such relationship.

The theory of internal colonialism constitutes one of the first challenges to MODERNIZATION THEORY, particularly of its dualist thesis. It also incorporates a critique of orthodox Marxist theory for its exclusive focus on class relations and its neglect of the important ethnic

dimension. The great strength and major contribution of the theory of internal colonialism is its exploration of the links between class and ethnicity, links which modernization and Marxist theories had failed to examine.

An elaborate definition of internal colonialism is provided by Dale Johnson:

Economically, internal colonies can be conceptualized as those populations who produce primary commodities for markets in metropolitan centers, who constitute a source of cheap labor for enterprises controlled from the metropolitan centers, and/or who constitute a market for the products and services of the centers. The colonized are excluded from participation or suffer discriminatory participation in the political, cultural, and other institutions of the dominant society. An internal colony constitutes a society within a society based upon racial, linguistic, and/or marked cultural differences as well as differences of social class. It is subject to political and administrative control by the dominant classes and institutions of the metropolis. Defined in this way, internal colonies can exist on a geographical basis or on a racial or cultural basis in ethnically or culturally dual or plural societies.

(1972: 277)

A series of characteristics which defined a situation of colonialism *between* countries in the past also exist *within* some contemporary independent developing countries. It is this similarity between earlier colonial relations of domination and exploitation between countries and those relations which exist today within some countries, which has prompted the use of the term 'internal colonialism'.

Internal colonialism differs from class relations because it cuts across class lines and is a relation of domination and exploitation of a total population by another population including all the different groups within it. Rural-urban and class relations cannot be fully understood without reference to internal colonialism, particularly in those developing coun-

tries with a significant indigenous population. Internal colonialism, by maintaining ethnic divisions, impedes the development of class relations as ethnic consciousness may override class consciousness. Thus internal colonialism gives a distinctive character to class relations.

The conceptualization of internal colonialism foreshadows the subsequent discussion on the articulation of modes of production (see *MODE OF PRODUCTION*). The imposition of forced labour and serfdom in plantations, mines and workshops that arose from imperialism, transformed Indian communities into labour reserves of the colonial economy. This led to the coexistence and combination of different social relations of production during the colonial period (that is, slave, feudal and capitalist). This combination of social relations explains the *UNEVEN DEVELOPMENT* arising from the technical, institutional and cultural heterogeneity of many developing countries. After independence, these colonial relations were gradually transformed into internal colonial (or endo-colonial) relations. Thus, the root of the uneven and heterogeneous nature of most present-day underdeveloped countries has to be sought in their colonial past.

The concept of internal colonialism overcomes the dualism of modernization theory. The subordinate Indian and dominant non-Indian economy and society, far from being independent of each other, are both integrated into a unique economic system in a unique society. However, internal colonialism fails to analyse the different social relations or their interaction in any detail. Through its mechanisms of monopolization, domination and discrimination, internal colonialism facilitates and intensifies the process of exploitation of the subordinate population by the dominant population, thereby enhancing the process of capital accumulation by the latter.

The development of *CAPITALISM* not only modifies internal colonialism, but may also destroy it. The destruction of internal colonialism can be brought about from above, but also from below. The former arises when the dominant classes no longer find relations of internal colonialism profitable or advanta-

geous, as they may impede technological progress and result in ethnic uprisings. In turn, horizontal class relationships may develop within the Indian population and a class alliance may be formed with urban workers so as to bring about the demise of internal colonial relations from below.

Internal colonialism can lead to a process of economic and social polarization between different geographical units within a country. Differences emerge between dynamic and peripheral regions: the development of one leading to the UNDERDEVELOPMENT of another. Through a variety of mechanisms, the dynamic regions extract a surplus from the peripheral regions, thereby contributing to their decapitalization. Thus internal colonialism can be likened to the metropolis-satellite structure presented by ANDRE GUNDER FRANK.

Efforts have also been made to apply the concept of internal colonialism to an analysis of ethnic and race relations in advanced capitalist countries. The appeal of the theory of internal colonialism is its utopianism, as it contains a hope for liberation from oppression and exploitation through ethnic, cultural and national autonomy. By raising political consciousness among those belonging to an internal colony, it hopes to fulfil the promise of liberation. But the structural conditions for proclaiming 'internal independence' and establishing a separate state are not very propitious in many situations of internal colonialism. Most internal colonies are far too enmeshed in and dependent on the national capitalist system for such a declaration of independence to be viable. Even if independence were to be achieved, the relations of exploitation and domination would not disappear so long as capitalism continued to prevail.

See also:

colonialism; development of underdevelopment; ethnicity; imperialism; nationalism; post-colonialism

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CRISTÓBAL KAY

COMECON see Council for Mutual Economic Assistance (CMEA)

command economies

A 'command economy', in which government control of the economy is extensive, can be understood as the polar opposite of a market economy. In all national economies, both developed and developing, the government intervention is neither entirely absent nor absolutely total. That said, the extent to which governments controlled market forces in what were termed 'command economies' was well beyond that typical in market economies.

Two types of command economies emerged between the two World Wars. One type appeared in fascist regimes and the other in the Soviet Union. Both, despite different ideological underpinnings, featured NATIONALIZATION of the economy, non-liberal political systems and a high degree of mass mobilization based on nationalistic appeals. The Marxist–Leninist prototype (see MARXISM–LENINISM) had been formed in the aftermath of the Bolshevik Revolution (1917–21) and was consolidated by Joseph Stalin in the 1930s (see STALINISM). The total eradication of private property and other elements of a market economy distinguished this type from the fascist variant.

In the post-World War II era, Soviet-type command economies prevailed not only in East European socialist countries, but also in some Asian and Third World countries where communist-led, one-party regimes were established (see SOCIALISM; COMMUNISM). Despite differences in rigidity and the diversity of reform experiences across the countries following the Soviet model, the fundamental features and problems of those command economies that were modelled on the Soviet system can be depicted as follows.

The machinery of government was thoroughly permeated from top to bottom by the communist party in what were one-party regimes. Public ownership of the means of production led to maximal bureaucratic controls. Bureaucratic personnel came from the so-called *Nomenklatura* system – that is, the list of party members from which the communist

party selected executives, from top-level government officials down to managers at the enterprise level.

The allocation of capital, labour and other economic resources were under the tight control of the state. Central plans covering fixed periods set mandatory targets for the national economy. For example, the first Five Year Plans were introduced in the Soviet Union in 1928 and in China in 1953. The central bank controlled the entire banking system in the absence of independent commercial banks. Not only did it issue money, but also monitored the accounts of each state enterprise.

Both wholesale and retail prices were determined arbitrarily by government officials and were, on the whole, responsive neither to consumer demand nor to profit considerations on the supply side. SUBSIDIES, consistent with the ideological thrust of socialism, meant that basic needs (such as foodstuffs, housing and healthcare) were provided to the public at prices lower than the actual costs of production. Chronic shortages, as well as surpluses of certain goods, were caused by the lack of a 'rational' price mechanism based on supply and demand.

Most forms of property were absorbed into the state sector. Non-state sectors, if they existed at all, were minimized. Most enterprises were owned by the state and peasants were integrated into cooperatives. Collectivization by force took place in many socialist countries (notable exceptions being Yugoslavia after 1953 and Poland after 1956). The informal sector (or 'second economy'), sometimes legal and sometimes not, provided the general population and the enterprises with otherwise inaccessible goods and resources, and thereby alleviated (to some extent) supply–demand disequilibria.

International trade was also monopolized by the state. Since importing and exporting were conducted by state-owned trading firms, world market prices had little influence on domestic prices. Exchange rates were arbitrarily set by the government for each transaction and currencies were inconvertible (see EXCHANGE RATE). A predominant share of foreign trade

was conducted among the command economies themselves within Comecon (COUNCIL FOR MUTUAL ECONOMIC ASSISTANCE (CMEA), 1949-91). The International Bank for Economic Cooperation was established in 1963 for the purpose of multilateral coordination of intra-Comecon trade. Soviet roubles, which were transferable among Comecon members but not exchangeable into hard currency, were used as the unit of account for trade transactions among command economies.

It increasingly became clear that the 'extensive' growth model practised by the command economies, in which massive amounts of capital and labour were invested according to central plans, resulted in various kinds of economic inefficiencies. Moreover, the resources available for investment in extensive growth eventually were exhausted. Since the communist party's 'legitimacy' in society depended on its guarantee of a rising standard of living for the masses, the socialist countries had little choice but to look for 'intensive' growth models that would make better use of existing resources.

Accordingly, the East European countries, as well as the Soviet Union and China, undertook various kinds of economic reforms. Decentralization of economic structures and the gradual introduction of market mechanisms into the command economies were attempted in one way or another. Limited autonomy was given to the peasantry and to some enterprises. But ultimately economic reforms were limited, so as to not encroach on the one-party regime's monopoly of power. After all, the ruling elites had vested interests in the gigantic bureaucratic machinery of the command economies. And, for many of the Soviet bloc countries, pressure from the Soviet Union also constrained the extent of economic reforms. By the end of the 1980s, except for China (which achieved impressive economic growth after launching broad reforms in the late 1970s), the decline of ECONOMIC GROWTH could not be reversed among the command economies. When the Soviet Union collapsed, so too did the command economies within the Soviet empire.

See also:

Bolshevik; capitalism

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SHOICHI ITOH

commercial paper

Commercial paper is a short-term unsecured tradable promissory note which corporations sell directly to investors. Originating in the United States, it has (since the mid-1980s) grown rapidly in other countries and in the EUROMARKETS. Euro-commercial paper exploded from \$12.6 billion in 1985 to \$59.0 billion in 1986, but subsequently fluctuated, totalling \$44.6 billion in 1995. A form of SECURITIZATION, the market was fuelled by the ability of large corporations to raise funds more cheaply than banks given the latter's poorer credit ratings in the wake of the DEBT CRISIS and the increased institutional capacity of arms-length markets.

TONY PORTER

commercial policy (CP)

Commercial policy (CP) for any country is a mixture of tensions and trade-offs between

commercial policy (CP)

national and international interest, and hence it is a true subject of international political economy (IPE).

The policy of liberal trade

Many developing countries have started opening up their economies since the 1980s to reap the advantages of liberalization. Trade liberalization is a part of the package of economic liberalization. But historical evidence overwhelmingly suggests that trade liberalization has to be preceded or accompanied by devaluation to prevent internal imbalance in a regime of FIXED EXCHANGE RATES. A country can, of course, liberalize trade without devaluation if it is prepared to increase absorption to reduce the current account surplus, but this is difficult for most of the LESS-DEVELOPED COUNTRIES (LDCs). Liberal trade aims to improve the long-term EFFICIENCY of the economy, but it may lead to recession and current account deficits. It is often hazardous to have both liberal trade and a fixed exchange rate system. However, for many reasons, trade liberalization may prove to be more important for developing countries than the fixed exchange rate regime. Liberal trade may indeed have some positive switching effect which may moderate, or even eliminate for some countries, the need for devaluation. However, the ideal of trade liberalization has many aberrations, such as TRADE BLOCS. Indeed, contemporary CP is an incoherent assortment of unilateralism, bilateralism, MULTILATERALISM and trading blocs. Underlying this range of options is the tension between national interest and international obligations, and the study of this tension is the subject matter of IPE.

Policy of protection

Protection may be a welfare-maximizing policy under certain circumstances. According to FRIEDRICH LIST, unless infant industries are initially protected, a country cannot successfully industrialize itself. But the lines of production receiving protection may not always ensure economic growth. In the context of economic

development, direct control of imports and exports may often be more helpful than the Listian principle of protection. In the short-run, protection minimizes the volume of international trade, whereas a development-oriented trade control policy maximizes it. However, recent research by Paul Krugman and others shows that protection granted to industries enjoying increasing returns to scale may be advantageous (Krugman, 1990). But the application of protectionism should be based on empirical facts rather than on theoretical prejudice.

Internal production policy

However well-managed a country's CP may be, the external surplus that it can create may get out of control unless there is a proper internal production policy (Dasgupta, 1986: 138-9). Import restriction of luxury goods may be helpful for maintaining the investment ratio implicit in the external trade policy, but if the shelter of import restriction allows the production of these import-restricted goods domestically, the very purpose of the policy is defeated. The goods whose import is restricted in order to save foreign exchange may not be the goods that can be produced with COMPARATIVE ADVANTAGE.

Export surplus mechanism

The CP of a poor country must aim at generating a sufficient export surplus for economic growth. In achieving this, export should be maximized and import minimized. But import restrictions cannot be a long-term measure. A prudent CP should take into account the need to obtain valuable foreign exchange for economic growth and imports. Import restriction, being a one-party decision, is easier than export promotion, which is a two-party decision. Therefore, a 'backward' economy should put more emphasis on import restriction. Controls may be imposed on the import of luxury items. Opinions may differ as to the rationale for a particular method of import restriction. The choice between meth-

ods of control (for example, **TARIFFS**, **QUOTAS** or state trading) depends on the socio-political environment of a country.

Tariffs may lead to loss of welfare and give rise to beggar-thy-neighbour retaliation (see **BEGGAR-THY-NEIGHBOUR POLICY**). Subsidies or tax reductions may be introduced in lieu of tariffs. The quota system, based on licensing, is discriminatory and may breed corruption. The principle of granting licences to the highest bidders seems commendable for many reasons. This method is a mixture of the quota system and high tariffs. But tariffs are determined by the state and cannot be adjusted to the market situation, whereas the price of an auctioned import licence is fixed by the competitive process and amenable to market mechanisms.

A realistic CP has to choose between a quota system supplemented by high tariffs or licence auctioning, on one hand, and, on the other, state trading. However, if the quota system leads to corruption, state trading can be an alternative. In any case, developing countries should aim at maintaining a **BALANCE OF PAYMENTS** equilibrium and seek to build up sufficient international reserve to bring about stability in their exchange rates.

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B.N. GHOSH

commodities

It might seem an easy, straightforward task to distinguish commodities from other goods. However, as one proceeds, substantial ambiguities arise. Using the United Nations' International Standard Industrial Classifications (ISIC) one finds products falling in three groups: (1) the primary sector – agriculture

and mining; (2) the secondary sector – manufacturing; (3) the tertiary sector – basically public and private services. The outputs from the primary sector can unambiguously be classed as primary commodities, or commodities for short, but this definition may be narrower than the everyday concept of commodities. Here, the problem is that the line between the primary and manufacturing sectors drawn by ISIC is often very early in the production process, before the product has reached its main marketable state. For instance, meat, paper pulp and refined copper are important primary commodities in international trade, but a significant proportion of their value has been added by the manufacturing sector through the activities of slaughterhouses, pulp mills, and copper smelters and refineries.

The **STANDARD INTERNATIONAL TRADE CLASSIFICATION (SITC)** employed to distinguish between different categories of goods in international trade, provides an alternative tool for defining commodities. Using this framework, we can define commodities to include: (a) food in a broad sense, (b) agricultural raw materials, (c) minerals and metals, and (d) mineral fuels. The advantage of this grouping is that its general structure is also adopted by bodies like the **UNITED NATIONS CONFERENCE ON TRADE AND DEVELOPMENT (UNCTAD)** and the **WORLD TRADE ORGANIZATION (WTO)**.

For analytical purposes, it is often useful to further group commodities into several categories. For example, on one hand, (a) food, and (b), (c) and (d), raw materials used by industry, on the other. This distinction is of great practical significance when it comes to forecasting patterns of demand. A majority of the food items, having a more indispensable character, are likely to experience lesser variations in demand over the business cycle than the other commodity groups. Food also has a smaller **INCOME ELASTICITY OF DEMAND** and hence a lower trend in demand growth in an expanding economy where consumers tend to spend decreasing shares of their income on basic necessities – **ENGEL'S LAW**.

commodity agreements

Similarly, the distinction between, on one hand, (a) and (b), agricultural products, and (c) and (d), mineral products, on the other, is relevant in that the supply of the former is dependent on the changes in weather, while that of the latter is not. In general terms, one can say that the price instability of agricultural commodities is more often caused by supply-side disturbances, while that of minerals (strikes and cartels notwithstanding) is more related to variations on the demand side.

Though each of the four groups contains many different products, the major substitutes for individual products are likely to be found within the same group. This is probably most evident in (d), the fuels group. An important implication is that prices within each group will have a tendency to move together over time.

Commodities can also be classed into those that are easily stored and those that are not. Refrigeration and preservation have rendered all commodities storable to some extent. The hard-to-store commodities are predominantly found in the agricultural groups, but there are many agricultural materials (jute, rice) which are easily stored for long periods of time. Storability affects a commodity market in at least two ways: (1) it commonly provides for an increase in the elasticity of supply, and (2) it increases the scope for speculative activity.

There are great variations among commodities in terms of the time it takes to add to production capacity. The production of some commodities, such as bananas, sugar or wheat, can be greatly expanded between two adjacent seasons simply by extending the area on which the crop is grown. In other commodities, like coffee, palm oil and most minerals, several years are commonly required between the decision to increase capacity and the start-up of production from that capacity. Even though the long-run PRICE ELASTICITY of supply for the two groups may be of the same magnitude, the short-run elasticity of supply for the latter will be much lower.

Finally, a distinction is often made between exhaustible and renewable resource commodities. This distinction is useful primarily in the designing of public policy, conservation pro-

grammes and the like. In this regard, many of the fears of commodity depletion or exhaustion have not been realized due to improved methods of recovery and re-use.

Perhaps the most controversial issue surrounding commodities is the so-called 'Prebisch-Singer thesis' (see PREBISCH-SINGER HYPOTHESIS) of secular decline in the commodity TERMS OF TRADE for developing countries – that is, the fall over time in the international purchasing power of developing country commodity exports. While the validity of this pattern is in doubt, the notion has been used as a rationalization for a strategy of diversification out of commodities and into manufacturing.

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ROBERT LOONEY

commodity agreements

International commodity agreements (ICAs) are designed to stabilize prices of primary COMMODITIES in the world market, although producing countries also have tried to use them to raise the level of commodity prices. ICAs may also be used to gather statistics and other commodity information and to promote their commodity's consumption. ICAs often have consuming as well as producing countries as members and have *economic provisions* (that is, the ability to intervene in their markets). Market intervention normally is carried out by using buffer stocks or export controls, or both. In the years since World War II, ICAs were established for cocoa, coffee, rubber, sugar, tin and wheat. Only the rubber agree-

ment continued to have economic provisions in operation in the mid-1990s. The wheat agreement fell into disuse in the 1970s and the tin agreement collapsed in 1985. The coffee, cocoa and sugar agreements, though they remained in existence, no longer influenced the market. ICAs suffered from the prolonged decline in real commodity prices in the 1980s, which highlighted the conflict of objectives between reducing price fluctuations and supporting the long-term level of price.

The rationale for commodity agreements is that there are gains to producing and consuming countries from stabilizing commodity prices. Price instability is greater for primary commodities than it is for manufactures: there are larger shifts in supply and demand, and there are long lags in supply response for many tree crops and minerals. Instability is undesirable for producers if it reduces demand in favour of substitutes with more stable prices and instability makes it more difficult for consumers of raw materials to plan their own production. Price instability can also lead to instability of producer incomes and export earnings, which may be serious for a country heavily dependent on primary commodity exports for its foreign exchange earnings. However, price instability can act to stabilize earnings if the source of price instability is shifts in supply rather than demand. Instability of export earnings also can be tackled by compensatory financing schemes like STABEX.

ICAs may operate a buffer stock alone, as in the cocoa and rubber agreements, or in combination with export controls as in the tin agreements. Export controls also can be employed on their own as in the coffee and sugar agreements. Another control device is the use of multilateral contracts, as in international agreements on wheat. Such contracts commit consumers to buy specified amounts at not less than a minimum price and commit producers to supply at not more than a specified ceiling price.

Buffer stocks consist of a stock of the commodity together with the finance to purchase further stocks. The cocoa, rubber and tin agreements all have operated buffer

stocks. They are used to maintain the price within a specified range. The buffer-stock manager will buy when the price is low and sell when the price is high. Within the range, there can be a specified level at which stocks *may* be bought (or sold) and a lower (higher) figure at which they *must* be bought (sold). The range within which the prices are to be stabilized often has been subject to bargaining between consuming countries (who would like prices to be low) and producing countries (who would like higher prices). In setting the intervention range, there is a serious problem in determining whether recent price changes are temporary fluctuations or an indication of a higher or lower trend in prices. There is also a danger that the willingness of an ICA to buy for stock may induce large individual producing enterprises to produce more than they would otherwise or to hold smaller stocks themselves; this is an argument for combining buffer-stock operations with export (or production) control. Buffer-stock operations are easier if the commodity can be stored without deterioration, as in the case of non-ferrous metals; for a commodity such as bananas long-term storage would be impossible.

Export controls reduce the need for the ICA to hold large stocks when prices are depressed. However, to the extent that production is not reduced, producers will need to hold the stocks themselves. Export controls have the disadvantage of freezing the pattern of production if they are employed for a long period. This prevents lower cost producer members from expanding their share of the international market, which is economically inefficient from the viewpoint of the world economy.

Thinking on international agreements for commodities dates back to work in the League of Nations in the 1930s, though even before then colonial governments cooperated to control international supply, for example in tin and rubber. The formation of ICAs was envisaged as part of the HAVANA CHARTER in 1948 for the formation of the INTERNATIONAL TRADE ORGANIZATION (ITO). The ITO was never established, being replaced by the GENERAL AGREEMENT ON TARIFFS AND TRADE (GATT),

and the early ICAs were set up under United Nations auspices. The first International Wheat Agreement was agreed in 1949, the International Tin Agreement was signed at the end of 1953 and the International Sugar Agreement started in 1954. The International Coffee Agreement dates from 1962, the International Cocoa Agreement from 1972 and the International Natural Rubber Agreement from 1980.

From the 1960s and 1970s onwards, thinking on commodity policy was heavily influenced by the activities of the UNITED NATIONS CONFERENCE ON TRADE AND DEVELOPMENT (UNCTAD) and its calls for a NEW INTERNATIONAL ECONOMIC ORDER (NIEO). Since less-developed countries are the largest producers of a number of important primary commodities, such as cocoa, coffee, natural rubber, tin and palm oil, discussion about ICAs in UNCTAD and other fora has had a strong flavour of negotiation between developing countries and developed market economies. UNCTAD's proposal for an INTEGRATED PROGRAMME FOR COMMODITIES (IPC) envisaged the establishment of common funding for buffer stocks for ten primary commodities of particular interest to developing countries. In practice, however, actual ICAs have operated independently.

While developing countries have stressed the goal of price stabilization in their negotiations with developed countries, the idea that prices should be 'remunerative' as well as stable has been an important part of the agenda. Particular problems arise where there are large differences in production costs among different producers, as in coffee and tin (and oil), since prices which are remunerative for marginal producers will generate large rents for producers with low costs.

The International Tin Agreement (ITA) is the only example of a commodity agreement collapsing in open financial default, and its experience illustrates the difficulties an ICA can encounter in the face of adverse market conditions. The sixth ITA went into force in 1982 after various delays. There had been a background of acute dissatisfaction among

many producer and consumer members about the operation of the fifth ITA, centring on the level of intervention prices. As the market weakened in the early 1980s with world recession, there was considerable consumer resistance both to export control and to the raising of the price range: the United States felt the ITA was acting like a producer cartel (see CARTELS). Three main factors, however, underlaid the ITA's collapse. First, while consumer demand for tin was stagnating, there was a massive increase in production from a non-member: Brazil. Brazil moved during the 1980s from being a minor producer to the world's largest, following the discovery of rich deposits in the Amazon region. Second, there was a substantial increase in export sales from China, which previously had rarely entered the market and was not an ITA member. In the face of these increases, and despite the use of export controls, the ITA was faced with having to hold off the market a far larger volume of stocks than it could finance. Forced into complex financial transactions in the spot and futures markets for tin, the ITA's demise was brought about, thirdly, by adverse movements in exchange rates. On the London Metal Exchange, where the ITA operated, the sustained appreciation of the US dollar in the early 1980s had resulted in the pound sterling price of tin rising. A sudden depreciation of the dollar in 1985 caused the tin price to fall, the ITA's buffer-stock manager was unable to meet his financial obligations on the London Metal Exchange and the tin agreement defaulted. Thereafter, the tin price went into almost free fall, and over the decade declined by more than that of any other major primary commodity. This fall continued despite the activities of the Association of Tin Producing Countries (ATPC) to rationalize export supply. The tin price also has been influenced by the fact that the American government has been disposing of surplus tin from a strategic stockpile which it built up during the 1950s, equivalent to about a year's world supply.

Although the default of the tin agreement does not necessarily mean other agreements are likely to collapse, the other agreements have all

faced severe problems. The wheat agreement fell into disuse as excess supply built up in the late 1960s and the beginning of the 1970s, with producers disagreeing over the price range. Disagreements among producer members caused the coffee agreement's economic provisions to lapse. The sugar agreement's ability to intervene in the market was undermined by the emergence of the European Union (EU) as a major exporter of sugar and the agreement's economic provisions were allowed to lapse. The International Cocoa Agreement has faced problems of chronic oversupply and too large a build-up of stocks for the buffer stock to be able to finance. The fifth cocoa agreement, started in 1993, abandoned the buffer stock and switched to exclusive use of supply control, which, however, had negligible effect on the market. The rubber agreement, though continuing to operate, did so at low prices.

There is still no consensus on whether the operations of ICAs did succeed in their aim of stabilizing, or raising, commodity prices. What is clear is that the collapse of some prices, particularly coffee and tin, can be blamed on the release of stocks once the agreements ended.

The climate of opinion now has swung against commodity agreements. The rhetoric of the NIEO has gone out of fashion. Many governments of both developing countries and industrial countries, for good or ill, had already switched in the 1980s to a greater belief in the operation of free markets. The US administration under Ronald Reagan in the 1980s became actively hostile to ICAs and particularly to the use of supply restriction. Some traditional arguments against ICAs have been resurrected: that national governments can hold larger foreign-exchange reserves to guard against fluctuations in export earnings; that consumers' interests are better served by allowing low-cost producers to expand, even at the expense of possible future insecurity of supply if traditional producers are forced out of business. Large numbers of developing countries have diversified away from primary-commodity exports into manufactures. In general, only the poorest developing countries

are still heavily dependent on commodities for their export earnings.

See also:

rent seeking; terms of trade

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JOHN THOBURN

commodity chains

The production of any good or service involves the complex integration of a multitude of discrete inputs and operations. Such interconnected processes can usefully be envisaged as a chain of linked activities. Conceptualizing

economic activities as being functionally organized in such a way has a lengthy history and different terms have been employed by different writers: for example, 'commodity chains', 'value-added chains', 'value chains', 'production chains', 'filières' and so on. Although these may differ in detail, they each embody similar basic principles. The major distinguishing feature of the commodity chain variant is that it explicitly takes the final product (commodity) as the starting point for analysis and works backwards through the sequence of operations to the initial inputs.

A commodity chain may be defined most basically as 'a network of labour and production processes whose end result is a finished commodity' (Hopkins and Wallerstein, 1986, reproduced in Gereffi and Korzeniewicz, 1994). A commodity chain consists of a series of linked nodes, each of which represents a distinct operation in the process of production. It can be regarded as a transactionally linked sequence of functions in which each stage in the sequence adds value to the process of production, whether of goods or services. Although services can be regarded as commodities in their own right, they are also the processes which constitute these transactional linkages within commodity chains. They form the means whereby the individual components of commodity chains are integrated and coordinated. Two dimensions of commodity chains are especially important: (1) how they are coordinated and regulated (that is, their GOVERNANCE structure), and (2) how they are geographically configured at different spatial scales.

Commodity chains are coordinated and regulated at two levels: economic and political. The primary level of economic governance is that of the business firm, notably the transnational corporation (TNC) (see MULTINATIONAL CORPORATIONS (MNCs)), through the multifarious forms of intra- and inter-organizational relationships that constitute an economic system. At one extreme, each function in a specific commodity chain may be performed by individual, independent firms, so that the links in the chain consist of a series of

externalized transactions – that is, the transactions are organized through 'the market'. At the other extreme, the entire chain may be performed within the boundaries of an individual firm as a vertically integrated sequence of operations. In this case, the links in the chain consist of a series of internalized transactions organized hierarchically through the firm's internal organizational structure. In reality, this sharp dichotomy between externalized, market-governed transactions and internalized, hierarchically governed transactions greatly oversimplifies the richness of the regulatory mechanisms in contemporary economies. The boundary between the internalization and the externalization of commodity-chain functions is continually shifting, as firms make decisions about which functions to perform 'in-house' and which to 'out-source' to other firms. In effect, we can observe a spectrum of different forms of coordination and regulation which consist of networks of inter-relationships within and between firms structured by different degrees of power and influence. Such networks increasingly consist of a mix of intra-firm and inter-firm structures.

Commodity chains are also regulated politically. Historically, the primary locus has been the NATION-STATE but commodity chains are also regulated at supra-national scales – through such institutions as the INTERNATIONAL MONETARY FUND (IMF) or the WORLD TRADE ORGANIZATION (WTO) – as well as through regional economic groupings such as the EUROPEAN UNION (EU) or the NORTH AMERICAN FREE TRADE AGREEMENT (NAFTA). Not infrequently, there are substantial tensions between the economic and the political forms of governance of commodity chains, as states attempt to regulate those parts of commodity chains located within their territorial boundaries. For example, it has become increasingly common for host governments to impose local content requirements on firms operating within their territory. By insisting on a certain percentage of inputs being sourced locally, a government can substantially affect the ability of a firm to organize its commodity chain in a form most profitable

to the firm. Conversely, the establishment of EXPORT-PROCESSING ZONES (EPZs) in many developing countries enhances the ability for firms to acquire inputs from the most optimal sources and to combine them with cheap local labour to produce lower cost exports. In both cases, the specific configuration of the commodity chain is modified by the actions of national governments.

Firm-state tensions, and their associated bargaining processes (see BARGAINING, STATE-FIRM (SFB)) are especially contingent on developments in the geographical configuration of commodity chains. Precisely where each element in a commodity chain is located geographically and how the geographical structure of the different parts of the firms involved are physically linked constitutes their second major dimension. Just as we can identify a spectrum of organizational arrangements for coordinating and regulating commodity chains so, too, we can identify a spectrum of geographical arrangements and configurations: a variety of spatial divisions of labour. At one end of the geographical spectrum, commodity-chain functions may be spatially dispersed, at the other they may be spatially clustered. Technological developments in transport and communications (leading to TIME-SPACE COMPRESSION), as well as in processes of production, have progressively enlarged the geographical scale at which commodity chains may be organized and configured. Between the two geographical extremes of the local and the global lie a multiplicity of geographical scales of operation that are linked in complex ways through the operation of commodity chains. Although different types of commodity chain may be configured geographically in different ways, there has undoubtedly been a secular tendency for commodity chains to become increasingly globalized.

The specific concept of 'global commodity chains' (GCCs) has been particularly developed by the sociologist Gary Gereffi in a series of publications since the early 1990s. Gereffi's framework has a specific intellectual lineage: that of WORLD-SYSTEMS THEORY. One un-

doubted strength of the GCC approach, therefore, is that it explicitly focuses on *cross-national* forms of economic organization. The scale is that of the core and periphery of the world system, and of the ways in which individual countries are inserted into this international division of labour.

A global commodity chain is defined as follows:

A GCC consists of sets of inter-organizational networks clustered around one commodity or product, linking households, enterprises, and states to one another within the world-economy. These networks are situationally specific, socially constructed, and locally integrated, underscoring the social embeddedness of economic organization ... The GCCs approach promotes a nuanced analysis of world-economic spatial inequalities in terms of differential access to markets and resources. Our GCC framework allows us to pose questions about contemporary development issues that are not easily handled by previous paradigms, and permits us to more adequately forge the macro-micro links between processes that are generally assumed to be discretely contained within global, national, and local units of analysis. The paradigm that GCCs embody is a network-centered and historical approach that probes above and below the level of the nation-state to better analyze structure and change in the world-economy.

(Gereffi and Korzeniewicz, 1994: 2)

Gereffi identifies four main dimensions of global commodity chains: (1) an *input output structure*: 'a value-added chain of products, services, and resources linked together across a range of relevant industries'; (2) a *territoriality*: that is, a pattern of geographical distribution that may be spatially dispersed or spatially concentrated; (3) a *governance structure*: the 'authority and power relationships between firms that determines how financial, material, and human resources are allocated and flow within a chain', and (4) an *institutional framework*: 'that identifies how local, national, and

international conditions and policies shape the globalization process at each stage in the chain.'

Gereffi concentrates primarily on the *governance structure* of GCCs. He argues that two dominant types of governance structure have evolved to coordinate transnational production systems: what he terms 'producer-driven commodity chains' (PDCCs), on one hand, and 'buyer-driven commodity chains' (BDCCs), on the other. PDCCs are those in which large TNCs control a tightly integrated production system, notably in capital- and technology-intensive industries (such as cars, computers, aircraft, electrical machinery). BDCCs, in contrast, are those in which the power to organize the chain lies essentially with large retailers, brand-name merchandizers and trading companies. The diagnostic feature of BDCCs is that the controlling firms do not, themselves, own production facilities; rather they coordinate dispersed networks of independent and quasi-independent manufacturers. Such kinds of governance structure are most evident, it is claimed, in labour-intensive consumer goods industries (such as garments, footwear, consumer electronics, toys) and in hand-crafted products (such as furniture). The rationale for the distinction between producer-driven and buyer-driven commodity chains lies in differential barriers to entry.

The major advantage of conceptualizing economic activities as chains is that it facilitates a level of both organizational and geographical disaggregation that is missing from most other forms of analysis. Organizationally, by focusing on the individual components in the chain and on the interconnections between them, we are better able to understand the fundamentally networked structure of economic activities. We are able to see that the connections between the components in the chain are as important as the components themselves. By focusing on the entire chain of functions, from the final commodity back through all the links to initial inputs, we can avoid being trapped within the often arbitrary bounds of conventional 'industries' or 'sectors'. A commodity-chain approach forces us to recognize the ways in which both production

and consumption are tied together not only through the conventional media of the formal political economy but also through the household sector.

Geographically, one of the major advantages of adopting a commodity-chain approach is that analysis need not be tied to any specific geographical scale. Indeed, the 'chain' concept usefully highlights the multiple geographical scales at and through which the global economy is articulated. In particular, it has substantial implications for studies in political economy through its recognition of the essentially cross-national organization of economic activities. How commodity chains are configured and reconfigured within and across national boundaries is a fundamental issue. How commodity chains are configured and reconfigured within and between such regional economic blocs as the EU, NAFTA and East Asia is as much a political as an economic concern. However, much empirical work needs to be done to capture the real benefits of commodity-chain analysis. To date, most of the empirical work has been confined to a small number of economic sectors.

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business firm, based on the notion of the value chain.

PETER DICKEN

commodity concentration of exports

A high commodity concentration of exports is a feature of many DEVELOPING COUNTRIES, particularly the poorest ones. Traditionally it has been interpreted as a natural consequence of COMPARATIVE ADVANTAGE. However, it is often the result of the narrowness of the local resource-base and the constraints imposed by limited domestic market opportunities. Concentration on a few commodities may sometimes reflect historical colonial legacies that oriented the export sector according to the needs of the colonizing country. Preferential arrangements between developing and developed countries also have encouraged concentration on the few most profitable activities. Commodity concentration of exports is likely to lead to a significant asymmetry between the pattern of domestic production and consumption – that is, to an economic structure where most of the few goods produced are exported and where many of the goods sold in the domestic market are imported. Economic concentration on a narrow range of exportable products considerably increases a country's vulnerability to external demand shocks (see VULNERABILITY, ECONOMIC). RISKS may also rise in the longer term if a country's exports are concentrated on products or markets that are growing slowly, or where the commodity faces a secular decline in price (the so-called 'Prebisch Singer thesis' – see PREBISCH-SINGER HYPOTHESIS). Furthermore, in the context of multilateral trade liberalization under the WORLD TRADE ORGANIZATION (WTO), those economies highly concentrated on a few exportable commodities may suffer particularly sharp margin erosions in their traditional markets. Imbalance in the economic structure means that either small movements in

the TERMS OF TRADE or increases in export-earning instability can have severe repercussions on the BALANCE OF PAYMENTS. These difficulties raise fears about the sustainability of the growth process and create a pressing need for economic DIVERSIFICATION.

See also:

geographical concentration of exports; least-developed countries (LLDCs)

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LUCA MONGE ROFFARELLO

commodity fetishism

'Commodity fetishism' is defined by KARL MARX in the first volume of *Capital* as the appearance in CAPITALISM of social relations as qualities of material objects or as interactions between them (see Marx, 1990 [1867]). When the exchange-value of a commodity appears spontaneously in people's consciousness as a quality of the commodity and not as a product of the relations between producers, EXPLOITATION is concealed. Thereby a historically determined MODE OF PRODUCTION is presented as part of a natural order. In the framework of MARXIAN ECONOMICS, classical political economy is charged with fetishism and the same is true of references to GLOBALIZATION and the 'will of international financial markets' as subjective factors in economic development.

The racist ethnology of COLONIALISM characterized as fetishism the religion of 'primitive' peoples, who, through ignorance (it was argued), deified animals and inanimate objects. Marx takes up the idea of misrecognition that

commodity power

is, the distinction between essence and appearance – but changes the methodological approach to it. First, he regards fetishism as a necessary illusion. He does not attribute it to ignorance, but considers it a structural element of capitalist production. Second, he analyses the fetishism of our own society, not that fetishism of ‘others’ (‘primitive thought’).

Four separate interpretations of commodity fetishism evolve in the Marxist framework:

- 1 Its expansion by means of the theory of reification. Every human activity is experienced as an item of property – that is, as a thing. Capitalism leads the entire society to ALIENATION (G. Lukács).
- 2 An analogous application of the theory to the juridical plane, where social relations are regulated ‘fetishistically’. The free subject in juridical discourse corresponds to commodity exchange in capitalism (E. Paukanis).
- 3 Rejection of commodity fetishism as an idealistic concept based on juridical ideology (subject/object) and ignoring Marxist analysis of CAPITAL and the STATE (L. Althusser).
- 4 Analysis of a more general capital fetishism. Capital accumulation leaves manifold ‘traces’ on things, which (necessarily) appear as qualities of things and not as an outcome of the production relations (for example, profit appears to be derived from the means of production). In this way, the antagonistic character of those relations is concealed (J. Rancière).

It is important to note that in *Capital* Marx does not use the term IDEOLOGY and that fetishism takes its place. Thus our concept of ideology within Marxist approaches depends on the meaning we give to fetishism.

See also:

labour theory of value

Further reading

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DIMITRI DIMOULIS

commodity power

‘Commodity power’ is the ability to use the ownership and control of commodities as a bargaining tool to achieve desired outcomes by virtue of a position of dominance in a given market. POWER is thus based on the influence derived from the possession of non-substitutable commodities.

Commodity power is most frequently associated with attempts in the 1970s by the THIRD WORLD to change the nature of international commodity regimes in their favour. For many Third World states, primary commodity exports constituted a large part of their total export earnings. The Third World identified a common interest, based on their heavy dependence on commodity exports. They presumed that prices for primary commodities were unstable and were declining relative to those for manufactures, and that through the control and regulation of commodity markets they could raise and maintain stable and remunerative prices. This would contribute to their economic DEVELOPMENT and political influence.

The most successful use of commodity power was the ORGANIZATION OF PETROLEUM EXPORTING COUNTRIES (OPEC) oil embargo in 1973 and the subsequent increases in the price of oil. OPEC’s success contributed to the perception that the control of commodity markets could be used as a means to bring about a major restructuring of international economic relations in favour of the SOUTH. Many Third World producers tried, somewhat unsuccessfully, to emulate this model.

See also:

economic power; market power; New International Economic Order (NIEO)

Further reading

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ANNA K. DICKSON

Common Agricultural Policy (CAP)

The Common Agricultural Policy (CAP) is the most important, at least in terms of financial outlay and amount of legislative output, of the EUROPEAN ECONOMIC COMMUNITY (EEC) policies. Agriculture was included in the TREATY OF ROME at the insistence of the French government to counterbalance the fact that Germany was expected to benefit the most from the establishment of a common market in the manufacturing sector.

While a liberal, free-market philosophy permeated the common market project as a whole, in the agricultural sector the EEC simply elevated and harmonized at the community level the protectionist and regulatory regimes existing at the national level. The CAP was meant to increase agricultural productivity and to ensure a fair standard of living for farmers through guaranteed internal prices, import levies, export refunds and direct subsidies. The main community body responsible for its administration is the European Agriculture Guarantee and Guidance Fund.

The CAP was so successful that by the 1970s it had turned the European food shortages of earlier decades into food surpluses. This created problems for the EEC, both internally and externally. Internally, apart from the difficulties of running a collective pricing system within a framework of floating national currencies, the cost of the CAP increased to the point that it came to account for almost 80 per cent of the EEC budget outlay. The policy,

moreover, was perceived as having a regressive effect on the distribution of income since it primarily benefited the larger, more efficient agricultural concerns that needed subsidies the least. Given, moreover, that agriculture had come to account only for slightly over 2 per cent of the GROSS NATIONAL PRODUCT (GNP) of the EEC, the CAP became an easy target for criticism. Food surpluses had to be stored, transformed or sold at a loss on the world market, since guaranteed internal prices were usually above world prices. The CAP thus caused increasing tensions with EEC trading partners, particularly the agricultural exporting countries belonging to the so-called 'Cairns Group'. They already resented the protectionist character of the CAP and were now enraged at the depressing effect on world prices caused by EEC sales of its surpluses.

Hence, pressures built for a reform of the CAP. Changes, however, proved difficult to implement because, although the percentage of people employed in the agricultural sector had declined steadily, the political clout of the farming lobby remained strong. In 1984, a quota system for milk production was introduced. Land set-aside arrangements, and production and spending curbs, followed in 1988. As part of the URUGUAY ROUND OF GENERAL AGREEMENT ON TARIFFS AND TRADE (GATT) negotiations, cuts were made in 1992 to guaranteed prices for most products. Finally, additional cuts and new spending ceilings were introduced in 1999 as part of the so-called *AGENDA 2000* package of EEC budget reforms.

These reforms have reduced the cost of the CAP to about half of the EEC's 82 billion euros annual budget. The view is rapidly gaining ground, however, that the CAP needs to undergo an even more radical reform before some eastern European countries with large agricultural sectors are admitted into the EUROPEAN UNION (EU).

OSVALDO CROCI

common fate

Discussions of a wide range of issues within contemporary world affairs reflect the idea that humanity is exposed to a range of conditions and/or developments that have identical, or comparable, effects and implications for all: a condition of 'common fate'. The famous BRANDT REPORT on North-South economic relations based its argument for a new and more equitable international economic order on the proposition that all parts of the contemporary international economy were bound together in equal and mutual DEPENDENCE; were, in short, all together in the same economic 'boat'. The weakness of many such discussions, however, is the failure to discriminate effectively between the conditions and developments to which such universal implications are ascribed.

A more discriminating approach to general ideas of common fate is particularly important when confronting the problems often encountered in negotiating and implementing effective international agreements on issues of apparently widespread interest and concern. The problems of creating effective international agreements and overcoming fatal free-riding tendencies (see FREE RIDER PROBLEM) on matters of common concern are substantial, as work on COLLECTIVE GOODS and PUBLIC GOODS has demonstrated. However, if some conditions of apparent common fate are not equally common in causation or effect, then international negotiations are likely to reflect, and even be damaged and free-riding tendencies amplified uncontrollably.

More precisely, conditions of apparent common fate can be differentiated into at least six basic variants:

- 1 the generation by a group of societies of effects that are experienced equally by all the members of the group;
- 2 the equal experience by all societies of effects that are generated by only one society, or a subgroup of societies;
- 3 the equal experience by a group of societies of effects generated entirely outside that group of societies;
- 4 the generation by all the members of a group of societies of effects that are experienced unequally by all members of the group;
- 5 the unequal experience by a group of societies of effects generated outside that group, and
- 6 where effects are transmitted from one society to others but where the transmitting society does not experience the effects directly and/or in the short-term.

It would be unsurprising if states that did not suffer the consequences, for example, of their polluting behaviour were to be less enthusiastic about costly agreements to limit the relevant forms of pollution than those who were their innocent victims. There will be similar difficulties where there are widespread imbalances between levels of responsibility of a given form of pollution and forms and levels of exposure to its consequences, as is possibly the case with GLOBAL WARMING. Negotiations under conditions of equal causation and equal effect, in contrast, will merely have to overcome the problems of free riding and, hence, under-supply of solutions.

Negotiations may not be futile under any of the different forms of common fate, but the ease and complexity of their conduct and resolution will certainly vary from condition to condition, as bribes, sanctions and even threats of force might have to be deployed to compensate for the lack of equal interest in the problem and its solution.

International negotiations on issues of common fate will be further complicated by a number of factors and considerations that conventionally operate in politics and international affairs. The time-scales of problems and solutions often bear significantly on the calculations of democratically elected governments, which often have relatively short terms in office. The general tendency to discount future costs (and rewards) will be reinforced by the knowledge that the negotiators are unlikely to be in office when the benefits of costly agreements are enjoyed, but may well still be in power when the costs are experienced by their potentially aggrieved electorates.

Negotiated agreements on issues of common fate may, however, be eased by the possibility of using market-based mechanisms for dealing with the problem at hand. The ultimate effectiveness of devices like tradable pollution quotas may be questionable, but such mechanisms are certainly attractive to democratic governments that are seeking to blend the constraints of electoral democracy with the vitality of the market economy by relocating difficult decisions on pollution control to the apparently impersonal mechanisms of the free market from the responsibility of politicians.

The achievement of effective outcomes on troublesome issues of common fate, on which multilateral agreement might prove difficult, can also be encouraged by the existence or development of 'privileged' actors or groups. Such actors or groups are those that are willing and able to generate a desirable outcome on some issue of common interest through the use of their own resources. Britain in the late nineteenth century and the United States in the immediate post-1945 decades were thus willing and able to provide the basis for a measure of global financial stability largely on the basis of their own economic and financial resources. An actor or group with an equally privileged position has yet, however, to emerge in the area of environmental pollution and global warming.

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R.J. BARRY JONES

Common Foreign and Security Policy (CFSP)

The European Union (EU) created the Common Foreign and Security Policy (CFSP) in the Treaty on European Union (TEU), which came into effect in November 1993, to enable it to speak with one voice to the world. It was preceded by European Political Cooperation (EPC), which had evolved from the 1969 Hague EPC summit. The development of a foreign policy profile was part of the aim of creating a political union in Europe. The transformation of EPC into CFSP in the TEU was evolutionary rather than revolutionary.

CFSP's aims are protecting the EU's independence, common values and fundamental interest; strengthening the member-states' and the EU's security; preserving peace; abiding by the principles and objectives of international law; promoting international cooperation, democracy, the rule of law, human rights and fundamental freedoms.

CFSP is an intergovernmental institution; its objectives are set by the European Council and decisions are made by the Council of Foreign Ministers ('the Council'). CFSP is the second pillar of the EU – it is distinct from the first (European Community) pillar and the third (Justice and Home Affairs) pillar (see EUROPEAN UNION (EU) for more details). EU member-states cooperate in different ways within CFSP by establishing common positions (which they must adhere to within international conferences and organizations) and by adopting joint actions over issues of mutual interest. While there is the possibility of qualified majority voting within the implementation of joint actions, the decision-making process within CFSP is typified by unanimity.

Common Foreign and Security Policy (CFSP)

The Commission (fully associated with CFSP at all levels) attends the Council where it has a non-exclusive right of policy initiation. Within CFSP, the Commission exerts its influence most strongly over economic issues (such as the imposition of sanctions – see *SANCTIONS, ECONOMIC*). However, CFSP is institutionally distinct from the other external relations of the EU. External economic relations are managed within the first pillar of the EU where the influence of the Commission is greater. Consistency between external relations and CFSP is ensured by the Presidency of the Council and the Commission. The European Parliament has a consultative role in relation to CFSP. A link with the Western European Union and CFSP is made in the TEU, which leaves open the possibility of its eventual incorporation within the EU and the framing of a common defence policy. The Amsterdam Treaty, signed in October 1997 but as yet unratified, modifies CFSP but does not radically affect its character as described in this entry.

The success of CFSP is normally assessed in two ways: the cohesiveness of the actors within CFSP in dealing with issues and the success of the actions in achieving their aims. Under both criteria the results have been mixed, with CFSP doing better in areas that are geographically distant and with longer term problems. There has been little success over issues like the war in the former Yugoslavia.

There is little written on international political economy (IPE) and EPC/CFSP, though many criticize the false distinction between 'low politics' (external relations) and 'high politics' (EPC/CFSP). Panayiotis Ifestos argues that the creation of EPC was proposed to strengthen the external powers of the economic community (Ifestos, 1987: 133). The development of EPC/CFSP in relation to the *ECONOMIC INTEGRATION* of the EU is mainly represented by the works of George, Bulmer, Holland and Ginsberg. Stephen George takes his approach from *WORLD-SYSTEMS THEORY* in explaining the development of EPC in relation to the growing

economic power of the *EUROPEAN COMMUNITY* (EC) and to understand differences in policy between the EC and United States over major international issues. Bulmer puts forward *REGIME THEORY* as an approach to explain the evolution of EPC, tying it closely to the economic development of the EC. Martin Holland, in his analysis of EPC/CFSP's relations with South Africa, draws on member-state domestic economic interests. Roy Ginsberg describes a self-styled logic which links regional integration and national interest together to produce foreign policy action (see Ginsberg, 1989; Holland, 1991).

Authors generally highlight the disparity between the economic strength of the EU and its weak foreign policy capability. However, Joseph Weiler and Wolfgang Wessels argue that, in terms of statistics, the EU appears to have great economic power but, as an economic actor, it is reactive, slow and incoherent; attributes it shares with EPC/CFSP (Weiler and Wessels, 1988: 256).

See also:

Maastricht Treaty

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JUSTIN HUTCHENCE

Common Fund

The Common Fund was the central piece of the INTEGRATED PROGRAMME FOR COMMODITIES (IPC) demanded by the South as part of the NEW INTERNATIONAL ECONOMIC ORDER (NIEO). Separate BUFFER STOCK agreements for stabilizing commodity prices were to be linked to the Common Fund providing financial resources. Experience before the sharp drop of all commodity prices in the 1980s suggested that a common fund would require less money than separately financed buffer stocks because of offsetting price movements of the commodities covered. The South favoured the 'source' approach: providing money for individual international commodity agreements (ICAs), the Fund should bring new ICAs into operation (see COMMODITY AGREEMENTS). The North favoured the 'pool' concept: already existing ICAs depositing resources in the Fund.

In 1979, the Resolution on Principal Elements of a Common Fund was adopted. The pool concept prevailed. The financial base for stabilization was \$150 million cash, \$250 million in guarantees and on call. It had been estimated that some \$4.5–7 billion were necessary. Additional but voluntary contributions of \$350 million were to finance the 'second window', RESEARCH AND DEVELOPMENT (R&D), diversification and so on. With 47 per cent of votes, the GROUP OF 77 (G-77) should contribute 10 per cent, which delinked financing somewhat from voting. Although the ORGANIZATION OF PETROLEUM EXPORTING COUNTRIES (OPEC) bankrolled the contribu-

tions of poor developing countries, ratification was extremely slow. The Common Fund came into existence in 1989; already obsolete as an instrument of commodity policy because of insufficient resources and the breakdown of ICAs.

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KUNIBERT RAFFER

common markets

A common market represents a particular level of international ECONOMIC INTEGRATION distinct from a FREE TRADE AREA (FTA) or a CUSTOMS UNION (CU). In particular, the term became synonymous with the EUROPEAN ECONOMIC COMMUNITY (EEC) prior to moves towards closer political and economic union.

Like other forms of economic integration, common markets aim to remove discrimination and impediments to trade from between the participating nations and to establish cooperation and coordination between them. However, common markets differ from customs unions in that they allow for free factor mobility across national boundaries. In other words, capital, labour and enterprise move unhindered between the participating countries. Like customs unions, common markets will have a common external tariff (CET) on imports from non-participant countries. A CET is a necessity since without it internal trade will be impeded, thereby defeating the purpose of a common market. Consequently SOVEREIGNTY over foreign trade and the right to conclude trade agreements with other states will be ceded. Besides the EEC, other examples of common markets include the CENTRAL AMERICAN COMMON MARKET (CACM) and MERCOSUR.

While the creation of common markets often has political motives, economic integration is primarily justified on the grounds of accruing

Communauté Financière Africaine (CFA)

economic gains. Perhaps the most common explanation for integration is that firms and industries can achieve increased production levels as a result of the ECONOMIES OF SCALE made possible by exploiting a larger market. Such economies of scale between the member-states would be impossible in isolation. Other potential benefits include:

- 1 enhanced efficiency in production made possible by increased specialization in accordance with the principle of COMPARATIVE ADVANTAGE;
- 2 improved international bargaining made possible by the larger size of the market, producing better TERMS OF TRADE;
- 3 enhanced competition enforcing changes in economic efficiency, and
- 4 factor mobility across the borders of the member-states and the coordination of monetary and fiscal policies stimulating economic growth.

Many economists distinguish between positive and negative aspects of economic integration. Most forms of integration are negative, in the sense that they involve the removal of discrimination between the member-states. However, the goal of creating common markets also requires positive economic integration. Namely, it requires the establishment and adoption of common policies and macro-economic coordination. Without positive integration, a common market will be effectively unviable; however, it is obvious that such steps will move common markets closer to full economic union. Indeed, many now maintain that common markets cannot be fully realized without economic union. The further development of the EEC into the EUROPEAN UNION (EU) provides a good example of this argument.

Although the TREATY OF ROME that established the European communities provided for the creation of a common 'internal' market between the member-states, what was missing from the original treaty was an agreed target date and a detailed programme for meeting it. Furthermore, although internal tariffs and

quotas had been removed, NON-TARIFF BARRIERS (NTBs) continued to provide obstacles to the free movement of goods and services. Consequently, in 1985 Lord Cockfield proposed that all physical, technical and fiscal barriers, and all internal border checks, should be eliminated by the end of 1992. In due course, Cockfield's proposals were adopted in the SINGLE EUROPEAN ACT (SEA). However, the removal of all barriers to an internal market clearly necessitated further movement towards economic and *monetary* union, and paved the way for the MAASTRICHT TREATY (1992) and the creation of the single European currency (1999).

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JASON P. ABBOTT

Communauté Financière Africaine (CFA)

The Communauté Financière Africaine (CFA), or French franc zone, has been one of the largest currency blocks in DEVELOPING COUNTRIES since 1948. The zone refers currently to fourteen African countries who have linked their currency to the French franc, enabling them to use the CFA franc for cross-border trade. The CFA zone is formed by two distinct regional monetary unions (the West African Monetary Union (WAMU) – sometimes called WAFZ or UMOA – and the Central African Zone – known as BEAC) and a single country, the Comoros. Since 1999, the CFA zone is *de facto* directly linked to the euro, with France being one of the euro-countries.

J.E.C. ENGELBERTS

communism

A communist society is generally interpreted as a classless, stateless society based on cooperation and common ownership of the means of production. Theoretically, the term has been particularly associated with KARL MARX. In practice, communism has been used to refer to the type of societies that existed under Communist Party rule, particularly across Eastern Europe before the revolutions of 1989.

Marx saw communism as the ultimate society, in which people could realize themselves in many diverse ways. The tyranny of natural necessity that tied individuals to the production process would be drastically reduced in communism, due to technological developments in the workplace. Marx envisaged the eventual displacement of the worker from the production process and the onset of automatic work processes. Increased automation would offer a drastic reduction in necessary labour-time, allowing individuals to pursue more creative activities that could enrich both themselves and others. The abolition of necessary labour, therefore, was seen by Marx as a prerequisite for the constitution of a communist society. Technological developments would ensure a superabundance of goods and allow the distributive principle 'from each according to their ability, to each according to their needs' to be followed.

Although communism is a future order or stage after SOCIALISM, Marx also referred to communism as being present in some form within existing society. The materialist basis to communism was the constant struggle of the working class for its own emancipation from the tyranny of commodity production in capitalism (see CLASS, WORKING). According to Marx, aspects of this struggle would offer indications of the new society already present in the old.

The path to communism has been interpreted in two main ways from Marx's writings, with an emphasis on either the forces or RELATIONS OF PRODUCTION. When the progression to communism is premised on the

development of the productive forces, a determinist tendency creeps into Marx's thought. The productive forces are depicted as progressing to such a level that they eventually, and inevitably, come into conflict with the social relations in society. For instance, the movement from FEUDALISM to CAPITALISM is captured in the technological developments that allowed a transition from an agrarian to a more industrial capital-based form of production. The prevailing social relations of lord and serf were therefore no longer compatible with the new productive forces. New social relations that corresponded to existing productive forces had to emerge: these were now to be capitalist and worker rather than lord and serf. The move from capitalism to communism via the transitional stage of socialism emanates through a similar contradiction. The incessant search for SURPLUS VALUE that typifies capitalism results in the constant revolutionizing of the forces of production. Labour is increasingly expelled from the production process to be replaced by machines. Capitalism is in a sense, therefore, creating the very conditions for communism itself, through the constant saving of labour. Just as feudalism collapsed because of the contradictions between the forces and relations of production, so too, it is suggested, will capitalist social relations break down and lead to initially socialism and eventually communism. The social relation of domination encapsulated between capitalist and worker ends, therefore, in the society of communism.

One problem with this strand of Marx's thought is that it neglects the need for class struggle in making communism a reality. Communism becomes an inescapable outcome of the development of the productive forces. If, as Marx suggests, however, all history is the history of CLASS STRUGGLE, then a greater emphasis is required on the social relations as the crucial factor, rather than the productive forces. Class struggle is, as any struggle, an open undetermined fight in which capital or labour may win. So communism has to be worked for and achieved by the struggle of the working class in and against the capitalist system.

In practice, the attainment of a communist society has not materialized despite various revolutions throughout the world that have expressed communism as an aim. Many regimes have termed themselves 'communist', even though the characteristics of communism in terms of abundance of goods and drastic reductions in necessary labour-time have in no way been achieved. In fact, communist regimes (as in the former Soviet Union) markedly increased working-time and even adopted capitalist work methods, such as TAYLORISM. Moreover, those regimes that call themselves communist have been so dictatorial that TOTALITARIANISM and communism have been seen as inseparable in practice. Politically, communism has become an almost unusable word and, in this light, many of the Communist Parties throughout Europe abandoned the term 'Communist' and adopted labels such as 'Democratic Left'. Ironically, however, a consequence of the rush to the free market in Eastern Europe has been a resurgence in Communist Party activity in some countries.

Although discredited very much in practice by the East European experience, communism in its classical sense, as developed by Marx, still has a positive role to play in thinking about the way society should be socially and economically organized. As a vision of a future order it still offers an alternative to capitalism in suggesting how human beings might live together. The increasing development of productive forces, especially in terms of increased automation, offers an indication of how moments of communism exist within capitalism. The more rational use of such labour-saving developments by an emancipatory working-class movement grasping for a new society still remains the goal of many communists. The evident failure of communist regimes throughout the world, however, also indicates the immense obstacles that remain along the journey to a future non-capitalist order.

See also:

determinism, economic; economism; Maoism; Marxian economics; Marxism Leninism

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IAN FRASER

communitarian values

Central to communitarian positions is the notion that the individual is defined by membership within a particular community and participation in its practices. The variety of theorists aggregated under the communitarian label make it difficult to outline a definitive set of communitarian characteristics. Nevertheless, common ground for these theorists is their rejection of the autonomous, pre-social self associated most strongly with the work of IMMANUEL KANT and their alternative understanding of the moral agent as embedded in a set of social relations. This commitment is seen to carry implications that provide sharp contrast to ethical cosmopolitan positions (see COSMOPOLITAN VALUES): obligations towards other human beings are constrained by more particular memberships; community boundaries have moral, and not merely instrumental, significance, and the primary moral subjects are particular communities and not their individual members.

Approaches described as communitarian are found in both political philosophy and normative theorizing within the discipline of international relations (IR). As an ascribed classification within political philosophy, communitarianism refers to the censure of LIBERALISM that returned to force primarily in the 1980s with the works of Alasdair MacIntyre, Michael Sandel, Charles Taylor and Michael Walzer. When communitarianism makes the

disciplinary shift to IR, it assumes one side of an analytical framework known as the communitarian/cosmopolitan divide and adopts a connotation that is absent in political philosophy: the morally constitutive community is understood as the sovereign, territorial STATE. Communitarianism thus conceived is closely linked to STATISM, as well as to some variations on REALISM, and is invoked to support the idea of the autonomy of states.

Because communitarians deny that there can be an evaluative criterion external to the community with which to judge competing ethical claims, the most common criticism that they face is one of moral relativism. Although this is a charge against which many communitarians defend themselves, it remains an important consideration in determining how far a communitarian perspective can travel in addressing international ethical concerns.

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TONI ERSKINE

Compagnie française d'assurance pour le commerce extérieur (COFACE)

The Compagnie française d'assurance pour le commerce extérieur (COFACE – French Insurance Company for Foreign Trade) was established in 1946. It specializes in risk management, particularly credit-market insurance and the management of French public export guarantees. Privatized since 1994, while it still maintains particular relations with the STATE, it also has many international clients, particularly in the THIRD WORLD. In 2000, it began to be traded on the Paris Stock Exchange.

ROBERT M. CUTLER

comparative advantage

The principle of comparative advantage lies at the core of liberalist international economics. It marks the origin of the highly abstract pure theory of international trade, which separates the economics of trade from the politics of trade. The argument for FREE TRADE is derived from the principle of comparative advantage. The principle states that the pattern of international trade is determined by relative cost differences in the production of traded goods. It predicts that specialization of production according to these relative cost differences, facilitated by free trade, will increase efficiency and improve global economic welfare.

DAVID RICARDO presented the principle in 1817 in *Principles of Economics* (1965 [1817]) as a stronger version of the principle of ABSOLUTE ADVANTAGE introduced by ADAM SMITH. Using a model consisting of two countries (England and Portugal) and two commodities (cloth and wine), Ricardo showed that there would still be gains from trade for both countries even where one of the trading partners had an absolute advantage in the production of both commodities.

comparative advantage

In Ricardo's model, Portugal has an absolute advantage in the production of both commodities. It produces both wine and cloth more efficiently than England. However, Portugal produces wine relatively more efficiently than it does cloth. Therefore, its comparative advantage lies in the production of wine. England has an absolute disadvantage in the production of both commodities. It produces neither commodity as efficiently as Portugal. However, it does produce cloth more efficiently than it produces wine. Therefore, England is said to have a comparative advantage in the production of cloth. Ricardo argued that both countries will gain by shifting their productive resources into the commodity in which they have a comparative advantage. They gain by exporting the commodity in which they have a comparative advantage and importing the commodity in which they have a comparative disadvantage. The gains are of two types. There is an efficiency gain resulting from increased specialization in the production of the commodity which uses relatively fewer resources per unit of output. The savings made on resource utilization leads to a gain in economic welfare due to the fact that both countries are able to purchase more of both commodities.

The principle of comparative advantage makes a number of assumptions about the nature of production. For example, it assumes that traded commodities are produced under PERFECT COMPETITION. Within the perfectly competitive framework, all commodities are produced under the assumption of constant returns to scale – a given percentage increase in inputs will always lead to the same percentage increase in output, regardless of the level of output. Therefore, as specialization increases due to the opening up of international trade, there will be no change in the marginal costs of production, no matter which commodity is being specialized in. This, in turn, means that it does not matter in which industries a country's comparative advantage lies. The principle also assumes that resources are internally mobile. This means that the movement of resources into the comparative advantage commodity is costless. Under these assumptions, free trade is

a positive-sum game. Both participants gain from free trade regardless of their level of development and the nature of the industries in which their comparative advantage lies.

Classical political economists in nineteenth-century Britain depicted comparative advantage as an exogenous, static phenomenon determined by a country's natural resources and climate. Ricardo based comparative advantage on the LABOUR THEORY OF VALUE. The modern version of the Ricardian model is usually depicted as explaining relative cost differences across countries in terms of differences in labour productivity. This suggests the possibility that comparative advantage could be derived through the exploitation of labour. The neo-classical version of comparative advantage, which was developed in the early part of the twentieth century (see NEO-CLASSICAL ECONOMICS), explained differences in comparative costs by differences in relative marginal utilities across countries. This allowed the theory of international trade to be developed mathematically as a branch of welfare economics. In the 1930s, Bertil Ohlin put forward relative factor endowments as an explanation for comparative advantage. This incorporated the market for factors of production into the model of trade first stated by Ricardo. The model became a two-country, two-commodity, two-factor, general equilibrium model – variously known as the 'factor proportions model of trade', the 'HECKSCHER OHLIN-SAMUELSON MODEL OF TRADE' and the 'neo-classical model of trade'.

This neo-classical model presents a static version of comparative advantage. Dynamic versions of the principle developed during the 1960s. These explain comparative advantage in terms of economies of scale, differences in technological development across countries and product life-cycles. However, due to their non-neo-classical nature, these explanations remained outside the standard theory of international trade until the 1980s.

The principle of comparative advantage ran into difficulties among trade theorists in the early 1970s with the recognition that figures for intra-industry trade (see TRADE, INTER-

INDUSTRY AND INTRA-INDUSTRY) across industrialized countries were growing. If two countries are successfully exporting the same commodity, then the model predicts that they both have a comparative advantage in that commodity. The model cannot therefore explain why two countries each with a comparative advantage in the same commodity would export that commodity to each other. Intra-industry trade is largely accounted for by the existence of PRODUCT DIFFERENTIATION. Since this is a feature of IMPERFECT COMPETITION, it contradicts the assumption of perfect competition that underpins comparative advantage.

The international trade models of the 1980s sought to reconcile comparative advantage with product differentiation. These models show that in a two-country world, where one country has a comparative advantage in the production of the high-quality version of a commodity and its trading partner has a comparative advantage in the production of the low-quality version of the same commodity, there can be gains from free trade in specializing according to comparative advantage. However, comparative advantage still cannot explain why trade in commodities produced using identical production functions would occur.

The principle of comparative advantage, as it is portrayed by the neo-classical model of international trade, is a static concept which cannot explain the dynamics of real-world industry and trade. In reality, industries experience increasing or decreasing returns to scale. Add to this the fact that industries also can experience growing or declining demand for their products, and it clearly does matter in which commodities a country's comparative advantage lies. If one country's comparative advantage lies in low-growth industries characterized by decreasing returns to scale, while the other country's comparative advantage lies in high growth, increasing returns industries, then it is no longer the case that specialization brought about by free trade based on comparative advantage is a positive-sum game.

The realization that it may matter very much in which commodities a country's comparative

advantage lies, led to the incorporation of trade issues into the theory of INDUSTRIAL POLICY. This introduces a political dimension into trade issues which had been excluded from the liberalist theory of trade. Strategic trade policies have focused on the generation of artificial comparative advantage. Governments and corporations of the Far East and latterly of Europe have used strategic techniques to develop advantages in high-growth, high-return, export-oriented industries. A well-known European example of strategic trade policy is the AIRBUS CONSORTIUM. Often, strategic trade policy incorporates protectionist measures while the artificial comparative advantage is being developed. The argument in favour of such protectionist measures is essentially the nineteenth-century infant industry argument, although in the modern-day equivalent, the protectionist measures usually take the form of NON-TARIFF BARRIERS (NTBs) and SUBSIDIZATION of developing industry. However, while INFANT-INDUSTRY PROTECTION is seen as a defensive and temporary policy, strategic trade policy is viewed as an offensive policy.

The principle of comparative advantage is clearly no longer as immutable as the pure theory of trade suggests. Comparative advantage is dynamic. It can be eroded over time as industries decline; likewise, it can develop as new technologies are revealed. It is not an exogenous phenomenon; on the contrary, it can be artificially generated through judicious use of government and corporate policy. Liberal trade theorists have been tenacious in their adherence to comparative advantage, but the models of the 1980s which attempt to marry comparative advantage with imperfect competition have reduced the principle to little more than a tautology, because they break the link between comparative advantage and relative costs. The argument for free trade may persist, but it can no longer rest on the principle of comparative advantage.

See also:

new trade theory

Reference

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SIOBHAIN McGOVERN

competition and government policy

From the time of the ancient civilizations, the role of government (economic) policies was to restrain and set the terms for competition. These policies were basically the result of political and economic considerations, which were in most instances closely related. The political factors influencing government policy towards free competition included foreign policy considerations, but also the protection of vested interests and special interest groups with political and economic power. For many centuries, the economic considerations for the restraint on free competition were rather a mix of common sense, trial-and-error and moralistic views, leading in most cases to rather catastrophic social and economic consequences.

However, after the development of economic science, and as early as the end of the nineteenth century, the importance of free competition for economic development and political liberty was appreciated; so was the need for its promotion and protection from monopoly power and from the attempts by oligopolies (trusts) to set prices above the competitive equilibrium (resulting in inefficient resource allocation and distortion of incentives). During this period, scientific developments and the rapid industrialization made feasible the emergence of big corporations that

acquired political and economic (natural monopoly) power and were able to engage in anti-competitive practices.

In the United States, where LAISSEZ-FAIRE capitalism was the cornerstone of the system (especially during the nineteenth century), antitrust law was developed quite early, with three federal statutes (the Sherman Antitrust Act, 1890; the Clayton Act and the Federal Trade Commission Act, both passed in 1914) supplemented by state legislation. The same happened in the United Kingdom with the Monopolies and Restrictive Practices Act of 1948 and ensuing legislation. A great portion of EUROPEAN UNION (EU) legislation is antitrust legislation.

The goals of competition policy are to control natural monopolies, to prevent the emergence of monopolies (by supervising mergers and acquisitions), to deter the collusive behaviour of big corporations (especially price-fixing agreements) and to discourage anti-competitive behaviour, like contracts in restraint of trade, predatory pricing, price discrimination, vertical restraints like full-line forcing (tie-in sales) and resale price maintenance (RPM), and so on.

However, a number of later developments in economic science challenged competition policy as unsuccessful for various reasons. According to John Clark, in many industries imperfections are insignificant and competition may not be perfect, but certainly is 'workable'. When this workable competition does not depart excessively from the model of PERFECT COMPETITION, there is no need for government REGULATION. However, Clark's concept was quite vague and not as refined as the views of the CHICAGO SCHOOL of antitrust analysis. Initiated with the work of Aaron Director (and later developed by Lester Telser, Robert Bork, Richard Posner and, of course, George Stigler), the Chicago School questioned the 'procedural' approach to antitrust (that is, that a practice is *per se* illegal) and favoured a more sophisticated analysis, attempting to assess the impact of the so-called 'anti-competitive' acts on the general WELFARE (rule of reason).

In a number of studies on vertical contracts, predatory pricing, RPM, mergers, even price-fixing, Chicago School economists showed that some of these practices may actually be competitive actions or have a pro-competitive rationale. For example, concentration alone is not an indication of inefficiency, since it may lead to cost reduction and lower prices. Furthermore, they endeavoured to prove (with the help of their public choice colleagues – see PUBLIC CHOICE (PC) THEORY) that the government failure of antitrust policy may lead to losses of welfare far greater than the losses from a possible monopoly, one of the reasons being that antitrust enforcement is often initiated by rivals of successful firms and government actions induced by special interests.

Similar conclusions are derived from the theory of the second best, according to which, if we accept that no competition could be perfect, then government policies which aspire to increase economic EFFICIENCY may not be the second-best policy. When there are multiple MARKET FAILURES in an economy, the best solution for a government may be non-intervention.

See also:

cartels; competition, economic role of; imperfect markets

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ARISTIDES N. HATZIS

competition between local and foreign industries

By the mid-1980s many policy-makers and economists had begun to identify competition between local and foreign industries as the critical determinant of a nation's prosperity. Two principal factors generated this emphasis on competitiveness. The first was the economic turbulence of the 1970s, during which many industrialized countries confronted falling profit rates, rising unemployment and/or falling real wages. The second factor was the simultaneous increase in international ECONOMIC INTEGRATION – particularly increasing international trade and FOREIGN DIRECT INVESTMENT (FDI). By the 1970s, Japanese firms had begun to win substantial market share in advanced industries. While Japan's firms expanded quickly, many US and European manufacturers retrenched – reducing output, investment and employment in the face of competitive failure.

Against this backdrop, observers argued that a nation's prosperity in the new global economy depended on the competitive performance of its domestic firms. The 1980s witnessed a plethora of prescriptions for restoring competitiveness. Three principal positions came to

competition between states

predominate in the 'competitiveness debate'. The first, inaugurated by Michael Piore and Charles Sabel's influential *The Second Industrial Divide* (1984), emphasizes industrial flexibility. They argue that by the 1970s the Fordist model (see FORDISM, DEVELOPMENTAL MODEL OF) of mass production of standardized goods using unskilled labour and specialized machinery had run its course. Henceforth, successful firms must target niche markets and adapt quickly to changing market conditions. The second, represented by William Lazonick's *Business Organization and the Myth of the Market Economy* (1991), focuses on corporate governance. Proponents of this approach argue that firms must incorporate their employees, suppliers and financiers into the corporate community to secure the willing cooperation that is needed to ensure the success of technological innovation. The third, advanced by Robert Reich in *The Work of Nations* (1991), emphasizes the importance of a nation's 'human capital'. Only those nations that promote the skills and training of their workforces will entice global corporations to locate their best jobs within their borders.

In contrast, many neo-classical economists view competitiveness as entirely inconsequential (see NEO-CLASSICAL ECONOMICS). They argue that a nation's prosperity depends on its own level of productivity growth, not on the competitiveness of its firms. Hence, they contend that the concern with competitiveness yields unwise economic policies.

See also:

competition and government policy; competitiveness of nations; Fordism, crisis of; industrial policy

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GEORGE DeMARTINO

competition between states

A political competition between states is a market-like process: it is analogous to the competition between economic agents in markets for goods and services. The essence of inter-state competition is the competition of immobile factors, including national laws and government policies, for internationally mobile resources such as footloose capital. Adaptation to external change is spontaneous and unilateral, not negotiated and reciprocal, as in cartel-like international regimes. To pessimists, this process is mutually damaging, as governments competitively lower standards (for example, environmental standards) in a 'race to the bottom'. To optimists (following David Hume), inter-state competition is mutually advantageous, as governments emulate each other in search of better institutional practices.

See also:

capital mobility; globalization; mercantilism

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RAZEEN SALLY

Competition Commission (CC)

The Competition Commission (CC) was established in 1998 by the Competition Act and replaced the Monopolies and Mergers Commission (MMC) in 1999. The Competition Commission's work consists of two elements: the reporting panel and the appeals panel. The reporting panel fulfils the same function as the old MMC. It investigates and reports on matters referred by the Secretary of State, the Director General of Fair Trading and the utility regulators. It investigates possible anti-competitive behaviour (a Chapter 1 Prohibition as defined in the 1998 Act) and the possible abuse of a dominant market position (a Chapter 2 Prohibition). Breaching a prohibition may result in a fine of up to 10 per cent of a firm's UK turnover. The appeals panel will hear appeals against decisions made under the prohibition provisions. The reporting panel also investigates mergers that have been referred and will disallow them if they are expected to operate against the public interest.

CHARLES WEIR

competition, economic role of

Competition is inevitable in a world of scarcity. Competition for scarce resources is essentially the object of economics. Economic competition, in its narrow sense, is the struggle in a market between sellers of goods and services trying to obtain the business and loyalty of a large share of buyers for as long as possible. According to the outcome of the struggle (and its other qualities), economic competition could be PERFECT COMPETITION, duopolistic competition (see DUOPOLY), OLIGOPOLISTIC COMPETITION or MONOPOLISTIC COMPETITION.

For NEO-CLASSICAL ECONOMICS, perfect competition ensures minimum-cost production and thus economic EFFICIENCY, since under the model of perfect competition the efficient allocation of resources is not distorted by monopoly power.

For an industry to be perfectly competitive, there must be a sufficiently large number of fully informed (and on average) small sellers (that is, sellers with no significant MARKET POWER), trying to maximize profit by selling a uniform good to an analogous large number of fully informed buyers. The marginal revenue gained should be equal to the sale price of the good and the firms should be able to enter and exit the market at no cost. In such an environment, each firm will set its output in such a way as to equalize its marginal cost to its marginal revenue – otherwise, it would produce too much or too little. Furthermore, free entry and exit will ensure that new entrants will bid down prices until the average revenue equals average cost. Then, the (economic) profit will be zero. This means that there will be no economic rent (the difference between the actual return made by a factor of production and the return necessary to keep the factor in its current occupation). Thus, in the long run (and since marginal revenue will equal average revenue in equilibrium), average cost will equal marginal cost, which in practice means that perfect competition ensures minimum-cost production in equilibrium and the lowest possible price for consumers.

The competition in an industry is duopolistic when there are only two firms competing. Under Antoine Augustin Cournot's model, a duopoly will inevitably lead to an equilibrium with an equal division of the market and the same price, which will be lower than the monopoly price but higher than the perfect competition price. Edward Chamberlin's theory of monopolistic competition emphasizes PRODUCT DIFFERENTIATION, which underscores the assumption of a homogeneous product, thus creating small monopolies that charge prices higher than in perfect competition. In the oligopolistic model of competition, a small number of firms compete in an industry where the entry of other firms is problematic (for various reasons, especially ECONOMIES OF SCALE or REGULATION). Oligopolies tend towards collusive behaviour and a joint price that is higher than the price under perfect competition (through explicit agreement or

competition state

tacit coordination with a price leader). In an oligopoly, firms could engage in inefficient strategic behaviour, in order to deter entry or competition by new firms.

There are many critiques of the model of perfect competition, the principal one being that it is unrealistic. However, it describes quite realistically many commodities and securities markets, especially in an era of GLOBALIZATION and FREE TRADE. It can also serve as a proxy for the evaluation of real markets, thus guiding competition policy. However, this view is challenged by (among others) the theory of SECOND BEST (a partially competitive market is not always the second-best regime), the managerial models of the firm (the motive of the firm is NOT PROFIT MAXIMIZATION but 'satisficing'), the theory of MARKET FAILURE (PUBLIC GOODS, EXTERNALITIES, transaction costs) and so on.

Competition (even perfect) is also attacked politically as a pseudo-positivistic justification of an unfair and unequal distribution of wealth. However, it is generally agreed that there is no better medium to ensure static and dynamic efficiency (innovation) than a competitive market.

See also:

cartels; competition and government policy; imperfect competition; invisible hand; welfare

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ARISTIDES N. HATZIS

competition state

Economic GLOBALIZATION does not translate automatically into political globalization. Political globalization requires a transformation of politics itself – that is, the metamorphosis of the nation-state into a 'competition state'. This process is profoundly paradoxical. In the first place, globalization can both undermine the domestic autonomy and political effectiveness of the state, and at the same time lead to the actual expansion of *de facto* state intervention and regulation in the name of competitiveness and marketization. Second, states and state actors are themselves among the greatest promoters of further globalization as they attempt to cope with 'global realities'. By chasing international competitiveness, they disarm themselves. States are getting more and more socially fragile too, further undermining the capacity of political and social forces within the state to shape and/or resist globalization.

Economic explanations of globalization are well known. The first is the interpenetration of national markets. The second is the advent of new technology. The third involves private and public economic institutions, from MULTINATIONAL CORPORATIONS (MNCs) to strategic alliances to private and public regulatory regimes. Sociological explanations focus on two levels: on the one hand, the spread of global images and identities from above – the 'global village'; on the other, post-modern cultural fragmentation, undermining all socio-political projects from below. From both economic and sociological perspectives, how-

ever, political institutions and practices are seen as epiphenomenal, dependent variables.

In contrast, globalization as a political phenomenon basically means that the shape of the political playing field itself, the possibility of effective COLLECTIVE ACTION internally and the capacity of states to make credible commitments externally, are increasingly determined outside insulated, autonomous, hierarchically organized states. Rather they derive from a complex mix of multilevel political games, played on multilayered institutional playing fields, above and across, as well as within, state boundaries. These three-level games are played out by state actors and other political forces, as well as market actors and socio-cultural actors. Furthermore, in a globalizing world, states play a crucial role as stabilizers and enforcers of the rules and practices of global society itself.

The essence of the post-war national industrial and welfare state (IWS) lay in the capacity which state actors and institutions had gained, especially since the GREAT DEPRESSION, to insulate certain key elements of economic life from international market forces while at the same time promoting other aspects of the market – this is known as EMBEDDED LIBERALISM. These mechanisms did not merely mean protecting the poor and helpless from poverty and pursuing welfare goals like full employment or public health, but also regulating business in the public interest, ‘fine-tuning’ business cycles to promote economic growth, nurturing ‘strategic industries’ and ‘NATIONAL CHAMPIONS’, integrating labour movements into corporatist processes to promote wage stability and labour discipline, reducing barriers to international trade, imposing controls on ‘speculative’ international movements of capital and the like. Following World War II, the expansion of these economic and social functions of the state came to be seen as crucial for the ‘modernization’ and ‘development’ of any country, rich or poor.

But this compromise between domestic regulation and international opening was eroded by increasing domestic structural costs (the FISCAL CRISIS of the state), as well as the

structural consequences of growing external trade and, perhaps most importantly, of international financial transactions and CAPITAL MOBILITY. Today, rather than attempt to take certain economic activities out of the market – to ‘decommodify’ them as the welfare state was organized to do – the competition state has pursued increased marketization since around 1980 in order to make economic activities located within the national territory (or activities that otherwise contribute to national wealth) more competitive in international and transnational terms (Cerny, 1990).

The challenge for state actors today, as viewed through the contemporary neo-liberal discourse of globalization (in both its economic and political versions – see NEO-LIBERALISM), is mainly to juggle four kinds of policy approaches: (1) a shift from macro-economic to micro-economic interventionism, as reflected in both DEREGULATION and INDUSTRIAL POLICY; (2) a shift in the focus of that interventionism from the development and maintenance of a range of ‘strategic’ or ‘basic’ economic activities in order to retain minimal economic self-sufficiency in key sectors, to one of flexible response to competitive conditions in a range of diversified and rapidly evolving international marketplaces – that is, the pursuit of competitive advantage as distinct from comparative advantage; (3) an emphasis on the control of inflation and general neo-liberal MONETARISM (supposedly translating into non-inflationary growth) as the touchstone of state economic management and interventionism, and (4) a shift in the focal point of party and governmental politics away from the general maximization of welfare within a nation (full employment, redistributive transfer payments and social-service provision) to the promotion of enterprise, innovation and profitability in both private and public sectors.

There have been some striking similarities, as well as major differences, between leading capitalist countries. The challenge is said to be one of getting the state to do both more and less at the same time. Traditional state intervention is notably poor at promoting so-called ‘intensive development’. Intensive development

may occur after or alongside 'extensive development', which involves bringing new factors of production into the economy. The former involves the endogenous efficiency of production, investment and market processes. It means continually improving the micro-economic efficiency, competitiveness and profitability of industry, including 'creative destruction' of old capital and technology to make way for the latest cutting-edge production, financing and marketing methods. It means giving individual owners, managers and workers market-based incentives to involve themselves in a day-to-day process of improvement of the competitiveness of the firm. The policy core of the competition state is an emphasis on the promotion of intensive development.

Potentially the most explosive issue-area is deregulation. However, deregulation must not be seen just as the lifting of old regulations, but also as the formulation of new regulatory structures which are designed to cope with, and even to anticipate, shifts in competitive advantage. Furthermore, these new regulatory structures are often designed to enforce global market-rational economic and political behaviour on rigid and inflexible private sector actors, as well as on state actors and agencies. The institutions and practices of the state itself are increasingly marketized or 'commodified', and the state becomes the spearhead of structural transformation to global market norms, both at home and abroad.

The original model of the competition state was the strategic or DEVELOPMENTAL STATE, which writers have associated with France and Japan (Johnson, 1982; Zysman, 1983). However, the developmental state, like traditional forms of state intervention, works best when it pursues extensive development. As more firms and sectors become linked into new international and transnational patterns of production, financing and market access, often moving operations offshore, their willingness to follow the national script declines. However, while Japanese administrative guidance and the ties of the *keiretsu* system have remained relatively strong (Vogel, 1996), in France the

forces of neo-liberalism have penetrated a range of significant bastions, from the main political parties to major sectors of the bureaucracy itself (Schmidt, 1996). The recent Asian economic crisis is essentially a crisis of the developmental state.

In contrast, the orthodox model of the competition state today is not the developmental state but the neo-liberal state. The flexibility and openness of Anglo-Saxon capital markets, the experience of Anglo-American elites with international and transnational business and their willingness to go multinational, the corporate structure of US and British firms and their (relative) concern with profitability and shareholder returns rather than traditional relationships and market share, the enthusiasm with which US managers have embraced 'lean management' and 'downsizing', and the relative flexibility of the US and UK labour forces, combined with an 'arms-length' state tradition in both countries, are widely thought to have fought off the strategic state challenge and to have eventually emerged more competitive today.

Throughout the debate between the Japanese model and the Anglo-American model, however, the European neo-corporatist model, rooted in the post-war settlement and given another dimension through the consolidation of the EUROPEAN UNION (EU), has been presented by many European commentators as a middle way. In bringing labour into institutionalized settings, not only for wage bargaining but for other aspects of the social market, in doggedly pursuing conservative monetary policies, in promoting extensive training policies and in possessing a universal banking system which nurtured and stabilized industry without the need for extensive strategic state interventionism, the European neo-corporatist approach (as practised in varying ways in Austria, Germany and Sweden in particular) has seemed to its proponents to embody the best aspects of both the Japanese and the Anglo-American models. Nevertheless, pressures to deregulate and flexibilize financial and labour markets are growing in Europe (Rhodes, 1998).

The search for competitive advantage adds further layers and cross-cutting cleavages to the world economy, which increase the complexity and density of networks of interdependence and interpenetration. Furthermore, genuinely transnational pressures can develop, whether from multinational corporations or from nationally or locally based firms and other interests (such as trade unions) caught in the crossfire of the search for international competitiveness. For the establishment or expansion of transnational regimes, transnational neo-corporatist structures of policy-bargaining, trans-governmental linkages between bureaucrats, policy-makers and policy communities, and the like. In all of these settings, the state must act more and more as a collective commodifying agent and even as a market actor itself (for example, the 'New Public Management' or 'reinventing government' – see Osborne and Gaebler, 1992).

States are consequently less and less able to act as unified hierarchical organizations and are more and more internally fragmented or 'splintered'. One result is that state actors and different agencies are increasingly intertwined with transgovernmental networks – systematic linkages between state actors and agencies overseeing particular jurisdictions and sectors, but cutting across different countries and including a heterogeneous collection of private actors and groups in interlocking, unevenly developed cross-border policy communities. These transgovernmental policy networks can help to set actors and agencies within the same state into increased policy competition with each other, further reinforcing wider transnational linkages.

The most egregious paradox of the competition state, however, is that the actual total amount of government economic interventionism and imbrication in social life can increase, while at the same time the power of the state to control specific social and economic activities and market outcomes continues to diminish. On one hand, financial globalization and deregulation have intensified pressures for governments to increase monitoring of financial markets, criminalize insider trading, stabi-

lize failing banks and stock markets, combat money laundering and the like. The growth of competing authorities with overlapping jurisdictions does not reduce interventionism, it merely expands the range of possibilities for splintered governments and special interests to carve out new fiefdoms, both domestically and transnationally, while undermining their overall strategic and developmental capacity (sometimes called NEO-MEDIEVALISM – Cerny, 1998). On the other hand, while some countries (because of their infrastructure, education systems, workforce skills and quality-of-life amenities) are able to attract 'footloose' *mobile factors of capital* of a highly sophisticated kind, others may increasingly have to depend on low-wage, low-cost manufacturing or agricultural production.

For an alternative way of understanding the competition state, probably the best place to look is US state governments. These governments can claim only a partial loyalty from their inhabitants, and their power over internal economic and social structures and forces has been limited indeed. They have been required to operate over the course of the past two centuries in an increasingly open continental market. Their taxing and regulating power has been seriously constrained in many spheres by the expansion of the weight and the legal prerogatives of the federal government. However, at the same time their ability to control development planning, to collect and use the tax revenues they do impose (as well as offering tax incentives and subsidies), to build infrastructure, to run education and training systems, to enforce law and order, and the like, gives these subnational states a capacity to influence the provision of *immobile factors of capital* in significant ways (Reich, 1991), indeed more than many governments in THIRD WORLD countries.

Global CONVERGENCE and divergence are therefore two sides of the same coin. Whether the forces of convergence will lead to a complex but stable pluralistic world based on liberal capitalism and the vestiges of liberal democracy, or the forces of divergence and inequality are creating a more fragmented and volatile

world, remains to be seen (Singer and Wildavsky, 1993). Whatever direction the future takes, however, political strategies and projects will increasingly become multilayered and globally oriented, whether on the Right ('globalization' in the sense of pursuing economic efficiency in a liberalized world marketplace) or on the Left (perhaps through a regeneration of genuinely internationalist socialism).

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PHILIP G. CERNY

competitiveness of nations

Competitiveness has become a pivotal concept for international political economy (IPE) in debates about economic performance during the 1990s. However, it is merely the most recent incarnation in a conceptual lineage for debating national economic development whose origins may be traced back to the first half of the nineteenth century and the work of FRIEDRICH LIST. List's publication in 1841 of *The National System of Political Economy* (1904 [1841]) provided the most comprehensive blueprint and political agenda for state-led industrial modernization for those national policy-makers wishing to remedy a condition of relative economic backwardness. More recently, the conceptual precursors of competitiveness have included national industrial strategies, DEVELOPMENTAL STATES and national systems of innovation.

Because its institutional and ideological components preclude its definition in narrow, economic terms, competitiveness has been seized upon by politicians as a means of justifying their particular political agenda. National governments and supranational institutions have used competitiveness as a vehicle for redefining their support for innovation in general and their industrial policies in particular. For example, the Major government in the United Kingdom set out its policies in a series of annual 'Competitiveness' White Papers and the European Commission's agenda for competitiveness was outlined in its 1993 White Paper 'Growth, competitiveness, employment: The challenges and ways forward into the twenty-first century'.

Despite its widespread use, the concept of 'competitiveness' has remained very elusive. This is because, as Kirsty Hughes has suggested,

There is no single unique measure of a country's competitiveness. It has to be understood as a relative concept – whether the comparison is over time or relative to other firms, sectors or economies.

(Hughes, 1993: 1)

Irrespective of how competitiveness is defined or measured, as Michael Porter has argued in his seminal contribution to the debate about the competitiveness of nations, an even more serious problem has been that there is no generally accepted theory to explain it, with the consequence that:

Innumerable characteristics of nations and firms have been proposed as important, but there has been no way of isolating and integrating the most salient ones.

(Porter, 1990: 12)

This confusion has led to the suggestion that competitiveness exhibits all of the features of an essentially contested concept: a variety of meanings, or connotations, with disagreement over which are correct and how to weight or combine them; difficulties in applying the concept, particularly in specifying the real-world objects (for example, firms or countries) the concept denotes, and differences in the way the concept is appraised, in so far as conflicting values and divergent preferences are embedded in its use (Rapkin and Strand, 1996: 110).

The ORGANISATION FOR ECONOMIC CO-OPERATION AND DEVELOPMENT (OECD) has drawn an important distinction between the competitiveness of a firm – which it has defined as the ability to produce the right goods and services of the right quality at the right price and the right time – and the competitiveness of a nation – which it has defined as the degree to which the nation can, under free and fair market conditions, produce goods and services which meet the test of international markets, while simultaneously maintaining and expanding the real incomes of its people over the long term (OECD, 1992: 237).

During the early 1990s, among the most widely cited contributions to the competitive-

ness debate were Robert Reich's *The Work of Nations: Preparing Ourselves for Twenty-First-Century Capitalism*, Lester Thurow's *Head to Head: The Coming Economic Battle among Japan, Europe and America*, Jeffery Garten's *A Cold Peace: America, Japan, Germany and the Struggle for Supremacy* and Laura D'Andrea Tyson's *Whose Bashing Whom? Trade Conflicts in High-Technology Industries*. The resonance of these contrasting perspectives on competitiveness on the actual conduct of policy has been demonstrated by the fact that, with the exception of Thurow, all these authors have served in the Clinton administration.

More recently, there has been something of a backlash against the idea that competitiveness is saying anything new or indeed constructive about economic development. Most notably, an important critique of the concept of competitiveness has been developed by Paul Krugman (for example, Krugman, 1994). In a series of polemical articles, he has suggested that a mistaken and dangerous obsession with competitiveness has developed among academics and policy-makers. This obsession has skewed domestic economic and trade policy agendas to the extent that it threatens the international economic system.

Krugman's contention is that the obsession with competitiveness has led to a neglect of what really matters for improving national economic performance and living standards, namely the rate of domestic productivity growth. For Krugman, productivity growth is determined by a complex range of factors, most of which are beyond the reach of government policy. As a consequence, he has dismissed the debate over competitiveness as simply a matter of time-honoured fallacies about international trade being dressed up in new and pretentious rhetoric (Boltho, 1996: 24).

Others (Prestowitz *et al.*, 1994) have suggested that the arithmetic underlying Krugman's critique of competitiveness is flawed (a charge that Krugman has disputed). Furthermore, they have claimed that loss of competitiveness, which may not be caused solely by domestic factors but rather through the rivalry of external competitors, will undermine living

standards and therefore cannot be dismissed as a dangerous and meaningless obsession. The debate continues apace (see Rapkin and Strand, 1996).

Perhaps the most valuable contribution that the concept of competitiveness has made to the discipline of IPE is that it has provided a very useful basis for commentators to debate the changes required to improve the performance of a national economy over the medium to longer term. Such debate has not necessarily led to any marked improvement in economic performance, as the recent experience of the United Kingdom demonstrates.

One danger arising from the idea of competitiveness, as with its conceptual precursors, is that it has the potential to seduce academics and policy-makers into undertaking spurious comparisons with other national economies. This could lead to the misunderstanding of what has happened overseas and, in turn, to the generation of misguided, ahistorical models of economic development that may be presented as panaceas for national economic development. The empirical record suggests that there is not a single trajectory of economic development that can be used as a blueprint for industries or individual firms when seeking to promote the competitiveness of nations.

See also:

competition between states; industrial policy; strategic trade theory

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SIMON LEE

complexity theory

Complexity theory has made a major impact on several fields, especially mathematics, physics and biology. It attempts to understand the dynamics of 'complex systems' comprised of many interacting and differentiated parts, all related to one or more of the others making up the system. Complex systems usually have internal hierarchical ordering, so that, above the lowest divisible unit of analysis, each system is comprised of what can be termed a 'system of systems' – a series of systems with each system nested in every other system (a 'nested hierarchy' of systems). These systems are infinitely divisible down to their lowest unit of analysis, but never simply the sum of their parts.

Self-organization is perhaps the most remarkable aspect of complex systems. Complex systems can develop a form that is not the deliberate outcome of agency, but the unintended consequence of the interactions making up the system. These interactions may be intentional or unintentional, but they have unintended outcomes which give rise to system-wide processes. Complex systems may also exhibit 'self-organized criticality'. When a critical threshold is reached, beyond which the existing state of the system cannot be sustained, the system will suddenly and dramatically shift its form into another state of existence. Consequently, when any one part changes, the consequences are system-wide.

In this way, complex systems can develop form and order, shift between different states of existence, collapse and disappear, entirely as a consequence of ENDOGENOUS FACTORS. Analysts of world politics have recently employed complexity theory to study global political change, in particular it is an important source of macrodynamic theory within INTERNATIONAL RELATIONS (IR).

See also:

chaos theory

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KEN DARK

component trade

One of the most significant elements in world trade consists of trade in components and parts which are used in the production of other finished goods. For example, an important element of world trade in automotive products consists of trade in autoparts, such as carburettors, speedometers, distributors, cylinder heads, exhaust pipes, alternators, car batteries, car lamps and so on. One of the main factors which has caused such trade to expand has been the process of rationalized production, or

compradors

vertical disintegration of the production process, to be found in many branches of manufacturing. Instead of the finished product being more or less wholly produced in a single establishment, the finished product is assembled in a specialist assembly plant, using a variety of components or parts bought in from specialist component suppliers located elsewhere. Once again, the car industry demonstrates this very well. A Ford Escort assembled at Dagenham in the United Kingdom uses components and parts produced in fifteen other European countries. Many of the components used in the production of a motor car have themselves been assembled from a large number of components produced in other specialist plants.

Much trade in components of this kind takes the form of in-house or intra-firm trade (see TRADE, INTER-FIRM AND INTRA-FIRM) – that is, trade between a parent company and a majority-owned affiliate in another country. Even if the two companies are not related through ownership, there is a strong probability that they will be linked in some other kind of contractual relationship. In the case of Japan, car manufacturers and component suppliers often belong to a vertically integrated *keiretsu* which ensures loyalty between supplier and manufacturer, reliability of delivery and control over quality.

Although western companies often view such linkages as an impediment to gaining access to the Japanese market, this close relationship has enabled Japanese car firms to successfully pioneer their now famous ‘just-in-time’ methods of production.

See also:

division of labour, international

Further reading

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and intermediate products in the motor industry over the last forty years.

NIGEL GRIMWADE

compradors

Derived from the Portuguese term for ‘buyers’, comprador was the ‘colonial’ term used in India and China by Europeans and European businesses to refer to the principal native servant who was both head of the staff of native employees and the purchasing intermediary between the house and its native customers. It was also the term applied to professional intermediaries who dealt with the foreign trading houses in the coastal enclaves of China in the late nineteenth and early twentieth centuries.

Later, in the twentieth century, ‘comprador elements’ or ‘comprador bourgeoisie’ was the term applied by Marxists and neo-Marxists (see MARXISM–LENINISM; NEO-MARXISM) to particular social strata in neo-colonial nation-states – that is, states which were politically independent, but economically dependent. It has been argued that to become economically independent of metropolitan capitalism, the neo-colonial states needed a radical redistribution of income, wealth and power, but that such a redistribution was opposed by the comprador bourgeoisie, who had a privileged position in the neo-colonial state. Typical constituents of the comprador bourgeoisie are landlords and commercial traders.

Thus it has been argued that such a comprador bourgeoisie have constituted a major part of the process of social and political integration between domestic interests and foreign capital. This integration takes place by various means, including the supply of ‘technical assistance’ (both military and civil) and AID from capitalist governments, which help to link the periphery with the economic core (see CORE, ECONOMIC) and to strengthen the ‘comprador regimes’. These links help to ensure that an autonomous process of capitalist development in the periphery is blocked and

instead leads to a further consolidation of UNDERDEVELOPMENT.

Thus, writers such as Jack Woddis and Colin Leys have argued that governments in neo-colonial states were and are rarely puppet regimes in the literal sense of the term, as implied in Kwame Nkrumah's *Neo-colonialism: The Last Stage of Imperialism* (1965). Instead, as Woddis puts it,

If ... the old system of colonial rule was, in essence, an alliance between external imperialism and local pre-capitalist forces, then neo-colonialism generally represents a new alliance, one between external imperialism and sections of the local bourgeoisie and petty-bourgeoisie.

(Woddis, 1967: 56)

In *Underdevelopment in Kenya* (1975), Leys argues that NEO-COLONIALISM and the comprador bourgeoisie have been characteristics of certain ex-colonies where the transition from colonialism to political independence permitted the relatively efficient transfer of political power to a regime based on the support of social classes linked very closely to the foreign interests which were formerly represented by the colonial state. Leys argued that Kenya has been an example of such a neo-colonial state.

See also:

core-periphery model; dependency theory; imperialism; structuralism

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CHRIS EDWARDS

conditionality

'Conditionality' is a term often associated with the conditions that the INTERNATIONAL MONETARY FUND (IMF) imposes on developing and transitional economies wishing to receive its loans to finance BALANCE-OF-PAYMENTS deficits. These conditions are controversial, since they often require major changes in economic policy, including severe measures to stabilize inflationary situations and large devaluations to correct balance-of-payments deficits. Conditionality also refers to the conditions imposed by the WORLD BANK on its structural adjustment lending and to policy conditions imposed by other aid donors. Critics have argued that conditionality has been a means whereby international agencies have forced free-market economic policies on reluctant THIRD WORLD governments and on the formerly communist countries of Eastern Europe.

The IMF has imposed conditions on borrowers since it started operations in 1946. Conditions were imposed once their borrowing had exhausted an amount equivalent to the borrower's first tranche (25 per cent of the borrower's quota) and the conditions became stricter as the borrower moved into higher tranches. Until the 1970s, most borrowing was by developed economies and conditions mainly involved limits on domestic credit expansion and other macro-economic indicators.

The IMF's lending resources since the 1940s have grown less by means of additions to members' quota subscriptions, than by the IMF being given powers to lend additional amounts against given quotas; quotas have grown relatively slowly compared to the expansion of world trade. As a result, the share of borrowing which is subject to low conditionality or to no conditionality has consistently fallen. Also, conditionality has been imposed even on the formerly largely non-conditional lending given under the Compensatory Financing Facility (established in 1963 to compensate developing countries for export shortfalls and replaced by the

Compensatory and Contingency Financing Facility in 1988).

The association of IMF conditionality with developing countries dates back to the early 1970s. After the BRETTON WOODS SYSTEM broke down over the period 1971–3, most industrial countries adopted FLOATING EXCHANGE RATES and, in consequence, the main focus of IMF lending switched to the Third World. By the early 1980s, most IMF loans were to developing countries.

However, the balance-of-payments difficulties of developing countries in the 1970s – following the ORGANIZATION OF PETROLEUM EXPORTING COUNTRIES (OPEC) oil price-rises – were met by a combination of commercial capital flows, bilateral lending and low-conditionality lending by the international agencies, including the IMF's oil facility (created in 1974). Conditionality became a particularly serious issue for developing countries with the onset of the DEBT CRISIS in the early 1980s, when it became associated not only with the imposition of tight macro-economic conditions, but with more general requirements about economic policy.

During the 1980s, the IMF began to make greater use of its Extended Fund Facility (EFF), created in 1974. The EFF, with repayment periods of five to ten years, represented longer term credit than the usual standby loans. In addition, the Structural Adjustment Facility (SAF) and Enhanced Structural Adjustment Facility (ESAF), provided concessional finance for poorer developing countries, but again (and especially in the case of ESAF) with policy conditions. With these facilities, the IMF took upon itself a major influence on the direction of borrowers' economic policies.

At the same time as the IMF was moving into longer term lending, the World Bank was moving away from lending for individual projects and towards more general programme-lending, conditional on economic policy changes on the part of borrowing governments. The conditions were generally designed to move borrowers towards the liberalization of their economies, particularly by reducing import quotas and tariffs, reform-

ing farm prices, freeing interest rates and reducing the size of the public sector. The logic was that even good projects might fail if policies outside the project's sector were inappropriate. For example, an irrigation project might fail in the absence of general agricultural price reform. Although the World Bank had started to expand its non-project loans in the 1970s, the 1980s saw a major growth in policy-conditional lending. The bank's Structural Adjustment Loans (SALs) and Sector Adjustment Loans (SECALs) were the main vehicles. SECALs were designed to provide support to a particular policy change, such as trade liberalization, whereas SALs gave more general balance-of-payments support to liberalizing economies.

The growth of longer term lending by the IMF under its EFF and ESAF facilities, together with the World Bank's SAL and SECAL lending, makes for considerable overlap in function between the two Bretton Woods institutions. It becomes significant whether or not the policy conditions attached to World Bank and IMF lending to a country are consistent. 'Cross-conditionality' also has become controversial. For example, in general the World Bank will not give an SAL unless the borrowing country has an IMF stabilization programme to deal with macro-economic imbalance.

The effectiveness of conditionality has been questioned in research by Tony Killick (1995). In a study covering twenty-one borrowing countries, he finds that policy conditionality only affects economic policy where the borrowing government is in agreement with the policy objectives set by the donor. Where there is disagreement, there is little evidence that the international institutions are willing to withhold lending to punish errant borrowers. Rather, officials of the donor institutions have agendas of their own, which involve strong pressures to increase lending and sometimes even to support failing policies with additional funds. There is a strong case for finance mainly being given to governments already committed to reform programmes.

See also:

stabilization policies; Washington consensus

CIEC, which has continued to meet and add additional members since 1977.

ROBERT M. CUTLER

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JOHN THOBURN

Conference on International Economic Cooperation (CIEC)

The Conference on International Economic Cooperation (CIEC), also called the North-South Dialogue, was held in several sessions between December 1975 and June 1977; the term is sometimes used to refer only to the inaugural meeting of the conference, held in Paris. It led to the creation of the so-called Group of 15 - a collection of THIRD WORLD countries coordinating their positions at the

Confucian model of development

The emergence of East Asia as the world's most dynamic economic region has spawned a vast explanatory literature. One of its themes asserts that distinctive Confucian cultural continuities shaped the dramatic emergence of East Asia. This entry argues that Confucian norms were a significant factor in the East Asian success story, but not the only one.

The claim that Confucianism played a constructive role is new. Not so long ago, in the first half of this century, Western scholars (including MAX WEBER), together with East Asian intellectuals and politicians, argued that it was precisely Confucianism that posed the biggest obstacle to modernization. Confucian familism prevented the emergence of the impersonal norms essential for industrialization. Confucianism placed a low value on commerce and channelled the energies of the talented into rote memorization of the Classics in order to pass the examinations that conferred status through entrance into the bureaucracy. Confucian beliefs and norms, which to varying degrees influenced all the East Asian states, shaping for centuries the political and the social order, were thus regarded as reactionary relics to be discarded.

The contrary, now dominant view, sees much in the Confucian tradition that proved adaptable to modernity and indeed provided the normative basis for the East Asian economic miracle. In this view, Confucian values persisted, transmitted both at the societal and official levels, as modernizing political elites redefined Confucian norms to adapt them to new purposes. They manifest themselves in several forms. First, it is precisely the high value that Confucianism places on the family that helps explain the powerful role that family

Confucian model of development

business played in the rise of East Asia. It commands the loyalty of its members, teaches respect for authority, subordinates the individual interest to that of the whole, and rewards diligence and hard work. The family acts as a managerial and entrepreneurial unit that strategically invests and reinvests its resources, and diversifies its undertakings. Confucianism as a whole (and the family in particular) attaches enormous significance to education, as measured by success in examinations, as a source of upward mobility, which helps explain the availability in East Asian societies of an educated workforce willing to be trained and to be responsive to authority. The family's meritocratic orientation also tends to temper, though not to eliminate, nepotism and, more generally, the reliance on personal relations (*guanxi*) which familism generates.

These values were transferable to non-family settings. They help explain the high propensity of groups to cooperate in the pursuit of collective goals, the loyalty of group members and their determination to live up to its expectations. The commitment to the pursuit of common, long-range goals helps explain the long time-horizons characteristic of East Asian investment practices and the successes attained in the strategically planned conquest of export markets.

Most important, the Confucian concept of the elite role of officials has been adapted to the tasks of development. Officials are recruited on the basis of merit. In addition, those in leading positions are expected not only to fill specialized, Weberian roles, but to act with a sense of responsibility for the public interest and the maintenance of social stability, somewhat along the lines of the 'father-mother' role of the traditional county magistrate in China. This is the normative foundation for the extraordinary role that highly talented officials – the term 'technocrat' is too narrow – play in the East Asian developmental states.

That Confucian norms played a role in the East Asian miracle is indeed plausible. To the extent that they explain the emergence of East

Asia, to that extent they pose a challenge to the methodological individualism of RATIONAL CHOICE theories (see INDIVIDUALISM, METHODOLOGICAL).

However, as is true of cultural explanations generally, their causal weight is difficult to determine. It would hardly do to attribute the close relationship between governments and business communities to Confucian norms alone, without examining calculi of gain. Important structural and situational factors proved conducive to development. Land reform in Japan, Korea and Taiwan, for instance, removed landed elites, thereby unleashing family energies. (The return to family farming in the People's Republic of China had a similar effect.) In a variety of ways, US influence and the international economy in the post-war era helped shape East Asian development in a positive direction. Moreover, East Asian societies vary in their adherence to Confucian norms. South Korea's repressive labour practices hardly exemplify Confucian ideals of reciprocity between those of unequal status. Confucian values are also not much help in resolving the contentious issue of just what the respective roles of government and the market should be. But it would be reasonable to conclude that Confucian norms predisposed East Asians to accept a high degree of government intervention and guidance.

There are indicators that adherence to Confucian norms is being undermined as East Asian societies democratize and the impact of globalization makes itself felt. The public no longer acquiesce as much as they formerly did in elitist, closed-door dealings. The exposure of 'money politics' in Taiwan, Japan and Korea, the product of corrupt business ties to government and political parties, indicates that Confucian reliance on interpersonal relations rather than impersonal legal norms is eliciting increased popular distrust; eroding respect for authority. As East Asian business enterprises turn into MULTINATIONAL CORPORATIONS (MNCs), their interests diverge from those of their home governments, thereby jeopardizing

the close cooperative relations between state and business.

See also:

East Asian model; Four Tigers (Asian); political culture

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THOMAS P. BERNSTEIN

**CONSEIL INTERGOUVERNEMENTAL
DES PAYS EXPORTATEURS DE CUIVRE
(CIPEC)** see Intergovernmental Council of
Copper Exporting Countries (CIPEC)

consumption

Consumption is the total amount spent in an economy on goods and services. This expenditure not only includes consumer goods and services, but also the raw materials used in manufacturing. It is the act of using a good or service, normally through their purchase, in order to satisfy consumer wants.

ALISON M.S. WATSON

contagion

Contagion, also known as SPILL-OVER, is the financial version of domino theory, where the effects of a financial crisis in one country spread to other countries. One notable example of contagion was the so-called 'tequila effect', where a run on the Mexican peso led to pressure on many Latin and North American currencies. Another example is the 'Asian flu', where a sell-off of the Thai baht led to crises and volatility throughout Asia and elsewhere. Contagion can occur for both fundamental and financial reasons. In the former case, a crisis in one country can be transmitted to others by way of trade links or competition. A country experiencing a currency crisis will affect its export competitors, as the depreciating currency makes its goods more competitive on world markets. If the crisis country also experiences a sharp economic downturn, it may affect others who rely on it as an export market. Contagion which is strictly due to financial factors can occur when a crisis in one country acts as a wake-up call for investors to pay closer attention to other countries that are in similar economic situations.

See also:

capital flight; financial panics and crises; herd behaviour

ADAM HARMES

Convention on Refugees

The Convention Relating to the Status of Refugees, signed by twenty states in 1951, entered into force in 1954. The convention is the main international legal instrument for the protection of refugees. It originally applied only to individuals who had become refugees as a result of events occurring (in Europe or elsewhere) before 1 January 1951. In 1967, this limitation was abolished by the Protocol Relating to the Status of Refugees. To date,

convergence

over 130 states have become parties to both these instruments.

The convention is centred around a refugee definition based on the existence of a 'well-founded fear of persecution for reasons of race, religion, nationality, membership of a particular social group or political opinion' (Article I). In addition to enshrining the principle of non-refoulement (according to which refugees should not be returned to their country of origin), the convention also obliges states to a certain standard for the treatment of refugees, which includes both civil/political rights and economic/social rights. The convention must also be interpreted in the light of international human rights law.

Partly in response to the criticism that the 1951 convention was not entirely adequate to the challenges posed by refugee crises in developing countries, regional instruments such as the ORGANIZATION OF AFRICAN UNITY (OAU) CONVENTION ON REFUGEES (1969) and the CARTAGENA DECLARATION ON REFUGEES (1984) were later developed.

See also:

migration, international; refugees; United Nations High Commissioner for Refugees (UNHCR)

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GUGLIELMO VERDIRAME

convergence

Convergence in the international political economy (IPE) generally refers to the narrowing of differences between national economies. This can take a variety of forms. For example, during the COLD WAR, according to the so-

called 'convergence hypothesis', convergence was specifically taken to mean that the communist bloc countries were becoming increasingly similar in economic terms to their counterparts in the United States and in other capitalist countries (or vice-versa) – such that the basis for potential political conflict would eventually be dissipated. The reasons for this can be largely attributed to contact and competition between the two blocs. Increased contact influences communist countries to behave more capitalistically, if only because the balance of technological exchange is, for the most part, not in their favour. Such increased contact leads, almost inevitably, to competition, because those competing for a share of the world export market begin to imitate each other – convergence takes place.

More recently, it is with regard to the issue of European integration that the concept of convergence has most often been used. First, in terms of the EUROPEAN MONETARY SYSTEM (EMS) of the EUROPEAN UNION (EU), convergence has been taken to mean the narrowing of international differences in the development of those economic variables that have a direct impact on EXCHANGE RATE stability. In this way, economic convergence was important in the continued maintenance of the EXCHANGE RATE MECHANISM (ERM). Moreover, in more recent years, the importance of the concept has been further recognized in the MAASTRICHT TREATY requirements that a country must satisfy in order to be eligible for membership of the ECONOMIC AND MONETARY UNION (EMU) – the so-called 'convergence criteria'. These criteria may be analysed under four main headings: (1) inflation rate convergence; (2) fiscal performance convergence; (3) exchange rate convergence, and (4) interest rate convergence. According to the inflation rate convergence criterion, the prospective members of EMU must maintain a high degree of price stability. For the year preceding entry, the average rate of inflation (as measured by the consumer price index (CPI)) must not exceed that of the three best performing member-states by more than 1.5 per cent. The fiscal

convergence criteria require that the government financial position be sustainable. Countries can proceed towards EMU if the ratio of the government budget deficit to GROSS DOMESTIC PRODUCT (GDP) is less than 3 per cent and if the ratio of the stock of outstanding government debt to GDP is less than 60 per cent. The exchange rate criterion states that the 'normal' fluctuation margins of the ERM must have been observed, without tension, for at least two years without a devaluation. Finally, the interest rate convergence criterion states that for the preceding year the average nominal long-term rate of interest must not exceed that of the three best member-states (in terms of low INFLATION) by more than two percentage points, with INTEREST RATES being measured on the basis of long-term government bonds or other comparable securities. The question of the nature of the convergence conditions necessary for the final passage to EMU occupied a central place in the intergovernmental negotiations prior to the signing of the Maastricht Treaty. In the end, the treaty basically embodied two principles. First, that the transition to monetary union be gradual: a long transition period is required in order that states attempt to meet the criteria. Second, that not all member-states had to join EMU at the same time: their accession is made dependent on satisfying the criteria. The point of these requirements, in general, is to ensure that the constraints on policy implied by participation in the EMU are likely to prove acceptable within the country concerned. Whether or not a country proceeds with EMU cannot simply be left for the government of that country to decide, due to the consequences implied for other members of the EMU of a bad judgement. For example, once exchange rates are fixed, as in a monetary union, any country whose prices rise substantially faster than the rest will lose competitiveness and market share. It therefore makes sense for a country to maintain a low-inflation target. In addition, there are institutional and individual member-state reasons for the nature of the convergence criteria. The lead in negotiations was taken by German and Dutch officials, with Spanish

backing. The latter had a preference for tough convergence criteria because of the desire to place itself in a straitjacket that would facilitate and legitimize difficult fiscal decisions at home. On the other hand, the German policy position was facilitated by the fact that the German economy would suffer if it entered into a monetary union which was without a firm monetary policy stance. It was, thus, within Germany's national economic interest to ensure that potential members were committed to a low-inflation stance before entering. This German stance was not, however, totally intransigent – the reason being that Germany was determined to achieve closer political integration in Europe and thus was willing, at times, to make concessions on EMU. As a result of this, many German economists and bankers believed that the convergence criteria were too weak. Other countries, however, were not so sure that tough convergence criteria were the answer. The Italian government, for example, suspected that tough convergence criteria were a way of reducing the prospects for Italian eligibility in the light of their unstable domestic political position. In European integration, then, convergence has a dual role: it is both an important indication of sound economic management, and an objective basis on which the political decision to advance to EMU will be made.

In more general terms, convergence between national economies may be the result of the increasing degree of contact which is taking place in the contemporary globalized international political economy.

See also:

capitalism; communism; competition, economic role of; globalization; price

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ALISON M.S. WATSON

conversion of arms industry

When defence procurement budgets are cut, often after wars, arms industries may shift production to serve commercial markets. Successful conversion minimizes disruption in labour markets, maintains stock market values of defence-dependent firms and applies advanced technology that had previously been classified to develop innovative consumer products. But economic, political and cultural factors may reduce the incentive to convert. Government efforts to stimulate conversion have brought mixed results. Even with government support, many firms that try to convert are thwarted by competition from existing commercial firms.

Historically, most private weapons manufacturers only entered the defence business as a sideline during wartime spending surges. The firms often produced weapons to blueprints developed by publicly owned arsenals and then returned to commercial business. Defence conversion policies focused on facilitating rapid technology diffusion to draw commercial manufacturers into the weapons business during mobilization. Proponents of full-blown commercial-military integration of the industrial base still seek to apply cutting-edge commercial technology, particularly in electronics and telecommunications, to weapons and to reduce the economic burden of defence procurement by spreading overheads and development costs. But the primary emphasis of modern defence conversion policy seeks commercial re-use of plant capacity formerly employed to make military products. This policy goal only emerged with the sustained high level of procurement during the COLD WAR. Cold War spending for the first time supported long-term, defence-dependent investment and employment with firms that specialized in serving military customers.

Workers defined their careers as defence industry employees.

Specialization has proven a barrier to many attempts by arms manufacturers to serve commercial markets. Even during the Cold War, some firms tried to diversify their customer base, either by developing commercial-oriented products or by merging with commercial-oriented firms. Product development often cost more than expected and found fewer customers than hoped for: mergers usually failed to produce synergies and firms' rates of return rarely changed much on either side of the business. One explanation is that the defence firms' core competency is their responsiveness to military customers, producing sophisticated, high-performance systems with little regard for cost/performance trade-offs. This skill, perfectly suited to the intense international quality competition of the Cold War, is not suited for adaptation to commercial markets and is unlikely to be made so by a policy change. Alternatively, some analysts blame the failures of commercial-military integration on complex defence procurement regulations that increase manufacturers' oversight costs. Conversion advocates, then, believe that acquisition reform, allowing the government to work more like a commercial customer, would facilitate ARMS INDUSTRY adjustment. Other conversion policies subsidize joint ventures between defence technologists and commercial firms, who might help teach the arms industry how to compete.

Defence firms' strategic choices may also undermine conversion efforts. A single weapons contract usually involves much more money than a deal with a commercial customer. Only a major (nearly unprecedented) commercial success will require as much labour and capital as a defence firm has on hand from its past military projects, so politicians' hopes that defence conversion will relieve constituents' adjustment costs are unlikely to be fulfilled. Political support for conversion may be difficult to sustain. Furthermore, defence firms' expertise in serving government customers offers executives an alternative strategy: the arms industry can lobby for pork-barrel

weapons projects that enable firms to continue in their familiar lines of business. These projects maintain employment and capital utilization, serving politicians' goals, but they do not contribute to domestic productivity growth, failing the economic goals favoured by conversion advocates. Finally, defence conversion is limited by the free-market economy. Few potentially profitable commercial niches remain unfilled, so converting firms usually must compete with established incumbents. The best examples of successful conversion have come in cases of pent-up consumer demand.

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EUGENE GHOLZ

convertibility, currency

A currency is said to be convertible when it can be freely exchanged for another currency or for gold. Currency convertibility is central to the contemporary banking industry. The central bank of a country (for example, the Bank of England, the Banca d'Italia) is the sole supplier of legal tender currency and commercial banks are obliged to make their deposits convertible, at par, into such currency. Thus, commercial banks must hold reserves, in the form of currency and deposits, at the central bank in order that they are able to honour their commitment to maintaining the convertibility of their deposits. If they did not do this, then a bank's clients would withdraw their existing balances from the bank. The contagious effect of such withdrawals could then precipitate a run on the bank.

In reality, however, many countries maintain constraints on the convertibility of their currencies. For example, in some cases bank deposits or other monetary assets may be frozen, thus limiting (among other things) the convertibility of domestic money into goods. Such a scenario took place in the former Soviet Union prior to the political and economic reforms of the early 1990s. Another option is to place restrictions on the convertibility of domestic currency into foreign currency. This is a more common practice and is often based on the same objective as for the currency conversion itself. In addition, convertibility restrictions may be put in place according to the residency or citizenship conditions of the party seeking to undertake the currency conversion. For example, many countries restrict the degree to which domestic residents are legally permitted to buy FOREIGN EXCHANGE for the purposes of building up financial or physical asset holdings in other countries.

Finally, many countries still maintain restrictions of some form or another on the amount of currency which it is legally permissible to convert. Such restrictions are related to the ability of a country to maintain its

cooperation

currency's stability. One example of some of the issues concerned with currency convertibility/inconvertibility is that of sterling. During World War II, sterling was inconvertible. Later, it was made a condition of the WASHINGTON AGREEMENT (1945) that sterling should be made fully convertible by July 1947. However, the gold and foreign exchange reserves of the STERLING AREA were unable to support the demand for currency conversion. As a result, sterling convertibility lasted only a short time (barely five weeks) and two forms of sterling eventually materialized: convertible sterling (earned by the dollar area countries) and transferable sterling (used to finance trade within the sterling area) which was not officially convertible. Eventually black markets arose in which the latter was converted into dollars at a discount. In 1955, the Bank of England began to support the black market EXCHANGE RATE which brought it into line with the official rate, meaning that, in the end, the convertibility of transferable sterling was admitted and, by the end of 1958, sterling became fully convertible.

See also:

Bretton Woods system

ALISON M.S. WATSON

cooperation

'Cooperation' is a central concept in orthodox theories of international political economy (IPE). The primary question concerning cooperation in orthodox IPE theory is whether or how cooperation can emerge in an anarchical world made up of self-interested NATION-STATES. Realist and neo-realist theorists argue that conflict or competition between states is more prevalent than cooperation in the world economy, since states will find it in their self-interest to compete rather than cooperate (see NEO-REALISM; REALISM). But liberal institutionalist theorists challenge this pessimistic view of cooperation, arguing that as the global

economy becomes more interdependent in more complex ways, the benefits of cooperation increasingly outweigh the costs. Despite significant differences in their assessment of cooperation, these two dominant approaches within IPE share an underlying scientific or rationalist approach to international politics, utilizing the insights of RATIONAL CHOICE and GAME THEORY (such as the iterated PRISONERS' DILEMMA). Moreover, as cooperation and cooperative institutions become an increasingly prevalent feature of the international political economy, neo-realist and neo-liberal theories have begun to converge regarding the issue of cooperation. The debate over conflict versus cooperation in orthodox IPE has largely shifted to a debate over the relative versus absolute gains of cooperation for participating nation-states.

See also:

collective goods; free rider problem

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NICOLE LINDSTROM

core, economic

An exchange economy consists of a set of economic agents, each of which can be described in terms of their preferences and initial endowments. Assuming no institutional constraints, agents can cooperate in order to exchange (or 'trade') endowments, thereby generating a redistribution. An imputation is any redistribution which exhausts the available endowments and yields to each agent at least the level of utility which it can be guaranteed in the absence of trade. A coalition of agents can, by exchanging the endowments of its members, improve on any given imputation if some of these members can be made better off while none is made worse off. The core of the economy consists of all of the imputations which cannot be improved upon in this way (or 'blocked') by any coalition. Such imputations are said to be Pareto optimal. An r -fold replication of an exchange economy consists of r identical traders of each type. Any core imputation yields to all traders of a given type the same allocation (the so-called 'equal treatment' property). As r increases, the core shrinks to the set of equilibria which would result if each agent were to maximize its utility, subject to a budget constraint and a set of perfectly flexible prices which clear all markets. There occurs, therefore, the following remarkable result: the outcome to unfettered trade in a replicated exchange economy without a price-mechanism is, in the limit, the same as that which obtains in a GENERAL EQUILIBRIUM economy with prices.

See also:

core periphery model; neo-classical economics

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R. ROTHCHILD

core-periphery model

The essential feature of the core-periphery model is that it assumes a single world (capitalist) economy within which there exist two poles with very different characteristics. The model is therefore relational, in that it sees the links between the core and the periphery as being fundamental to the development of both the parts and the whole. It is also structural, in stressing the importance of differences in the economic, social and political structures of the two parts. It is not possible to speak of a single core periphery model, since it has appeared in various formulations at different times and in different places. Even the precise terminology differs: for example, centre-periphery, metropolis-satellite, core-periphery. Some form of core periphery model is central to Latin American STRUCTURALISM, DEPENDENCY THEORY and WORLD-SYSTEMS THEORY. It is more accurate therefore to refer to a range of models with certain common features.

The systematic development of such models emerged in the period after World War II. Although clearly the pattern of UNEVEN DEVELOPMENT (which these models set out to explain) had long been in existence and individual writers (such as FRIEDRICH LIST) had challenged the dominant economic orthodoxy of the Ricardian theory of COMPARATIVE ADVANTAGE, these challenges did not amount to an alternative model of the world economy.

The first core-periphery models were provided by the Latin American structuralists associated with the Economic Commission for Latin America (ECLA) (particularly RAUL PREBISCH) in the late 1940s and 1950s. For ECLA, the world economy was divided into an industrial centre and an agrarian periphery. There were two crucial structural differences between the economies of the centre and those of the periphery. First, while the

core-periphery model

advanced economies were internally homogeneous with similar levels of productivity in different sectors and regions, those of the periphery were characterized by heterogeneity as a result of the coexistence of sectors with widely differing levels of technology and productivity. Second, while the advanced economies were diversified, those of the periphery were specialized in a relatively limited range of activities, particularly in the primary sector (agriculture and mining).

Under these conditions, the expansion of the world economy and closer links between the centre and the periphery tended to lead to increased international inequality, as opposed to being mutually beneficial (as the theory of comparative advantage predicted). A major mechanism through which such polarization took place was the long-run tendency for the TERMS OF TRADE to move against primary producing countries. This was explained in terms of the differences in demand and supply conditions affecting the production of primary products and manufactured goods. On the demand side, the INCOME ELASTICITY OF DEMAND for primary products in the advanced economies was relatively low, while that of the periphery for manufactured goods was much higher. Thus economic growth led to an increasing gap between the demand for the periphery's exports and the periphery's demand for imports. This was reinforced, on the supply side, by differences in the ways in which productivity gains in the centre and periphery were distributed. Whereas higher productivity in manufacturing in the centre tended to lead to higher profits and wages, in primary production in the periphery it tended to lead to lower prices. Thus the countries of the centre gained both from their own productivity advances and those achieved in the periphery.

By the 1960s, a number of the economists associated with ECLA had become radicalized and, with other writers from the Marxist tradition, converged to develop what came to be referred to as dependency theory. They also adopted a core-periphery model in opposition to the stages approach of W.W. ROSTOW, MODERNIZATION THEORISTS and orthodox

Marxists (see MARXIAN ECONOMICS). Whereas the ECLA structuralists had focused on trade as the key relationship between centre and periphery, dependency writers took a much broader approach. Central to much of this analysis was the notion developed by PAUL BARAN of the drain of surplus from the underdeveloped countries. Dependency theory focused on a range of mechanisms through which surplus was transferred from the periphery to the core, and the ways in which the dependency relation created and reinforced economic and social structures which were inimical to development at the periphery. Economic mechanisms which were identified included not only adverse terms of trade, but also the activities of transnational corporations (TNCs) (see MULTINATIONAL CORPORATIONS (MNCs)), foreign debt and interest payments, and CAPITAL FLIGHT. Moreover, the lack of a 'national' bourgeoisie prevented the classical form of capitalist development being replicated in the periphery.

These ideas were popularized in English by ANDRE GUNDER FRANK, who used the term 'metropolis-satellite' and portrayed the world economy as a hierarchy of metropolis-satellite relations in which the lower levels yielded surplus to the higher levels. While the earlier structuralist economists had identified the key division as one between an industrial centre and an agricultural periphery, dependency writers focused more on the concentration of technological and financial power at the core. For many of them, the core was characterized by its own internal dynamic of autocentric development, whereas the production structures of the periphery were disarticulated. The key emphasis here was on the absence of a capital goods sector in the countries of the periphery and the location of new technological development in the core.

In the 1970s, the core-periphery model came to form the centrepiece of the newly emerging world-systems theory to which a number of dependency writers now turned. Whereas the earlier formulations of the model took as their starting point the problems of development in the periphery and considered the ways in which

the relation of the periphery to the core affected the former's development, the starting point of the new approach (as its name suggests) was the system as a whole. Core and periphery now came to be seen more as linked processes, which tended to be reflected spatially, than as linked locations. One of the major consequences of these processes was the formation of strong and weak states within the framework of the interstate system. Various worldwide political, economic and cultural mechanisms tended to make it profitable for firms to allocate production processes internationally, so that some areas had a disproportionate share of labour-intensive activities carried out by low-wage labour, while others concentrated skill- and technology-intensive activities.

While earlier core-periphery models had implicitly assumed that it was possible for either a nationalist or a socialist state to transform its peripheral position to promote development, the world-systems approach emphasized the obstacles which the system as a whole placed in the path of any such change. Opportunities for change only arose under specific conditions at the level of the system as a whole, such as changes in the ebb and flow of interstate rivalry, or in relation to the long waves of capitalist development.

Although the world-systems approach continued to emphasize the bipolar nature of the world economy found in earlier formulations, it also introduced a third category of semi-periphery, defined as regions with a mix of peripheral and core activities. The existence of such a semi-periphery helps to depolarize the core periphery hierarchy, by providing intermediate actors which – under certain conditions in the world system – may have opportunities for upward mobility.

The core-periphery model has been a key element of a number of approaches in international political economy (IPE) since World War II. Although the specific factors which distinguish the two poles differ between theories, as do the precise mechanisms which tend to create and reproduce this bipolar system, they share a common starting point in identi-

fying the core periphery divide as the key structural characteristic of the international system.

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RHYS JENKINS

Corn Laws

The Corn Laws were instituted in an effort to benefit the producers of agricultural products during periods of low prices. Such legislation was instituted in Great Britain many times in the seventeenth century and even earlier. However, only the Corn Laws that were imposed in 1815 became controversial. The purpose of the Corn Laws was to raise the price of English corn (but also wheat, barley, rye and oats) and preserve the English farmers' monopoly by prohibiting the import of foreign corn until the price of domestic corn had reached a certain level (in the case of wheat, the level was 80 shillings per quarter). With the exception of landowners and larger farmers, almost all sections of the population were adversely affected by the government's efforts to indirectly raise the price of bread. As a consequence, the Corn Laws found strong opposition from both consumers and manufacturers. The government instituted a new sliding scale of duties

in 1828 (in the case of wheat, a duty of 1 shilling when its price was 73 shillings per quarter). Between 1828 and 1831, harvests were bad and corn was imported. In the better years which followed, the price of corn was kept low and the demands for the repeal of the Corn Laws died down. The government further modified the scale downwards in 1842, until the total repeal of the Corn Laws in 1846.

Most of classical economists were opposed to such laws. ADAM SMITH, for example, objected to such legislation because he thought that it interfered with FREE TRADE. DAVID RICARDO argued against the Corn Laws because they raise the domestic price of agricultural products, with the result that production expands to marginal (and therefore less productive) lands, the cost of food increases, wages increase, profits fall and society enters the stationary state. THOMAS ROBERT MALTHUS favoured the Corn Laws and he tried to reconcile this position with his free-trade views. J.S. MILL, as a free-trade supporter, objected to the Corn Laws; nevertheless he did not envisage significant benefits from their repeal. Indeed, the repeal of the Corn Laws did not bring any significant reductions in the prices of agricultural products, although it stabilized the amounts of agricultural products that were annually imported.

LEFTERIS TSOULFIDIS

corporatism

'Corporatism' is a complex phenomenon that can be considered from at least three different perspectives: it is (1) a highly polyvalent term in political and ideological discourse, (2) one of the most recurrent yet also historically variable patterns of economic, political and social organization in complex societies, and (3) one of the most contested concepts in political science and (international) political economy.

From all three perspectives, corporatism is seen as a general form of functional representation. It comprises a system of representation, policy formation and policy implementation

that is based on the alleged function in the division of labour of the various forces involved. This definition fixes the generic features of corporatism. It ignores the specificity of particular instances that are derived from the secondary features of corporatism in different circumstances. Such features include its ideological justification, its political legitimation, its functional bases and precise organizational forms of representation, the various levels at which corporatist structures are organized, the actual scope, purposes and mode of policy-making, the particular forms of implementation, and the place (if any) of corporatism in the state system as a whole. These generic and secondary features can now be related to the three above-mentioned perspectives on corporatism.

Discourses of corporatism

Corporatism is best seen as a more or less significant element in the repertoire of Western political discourse, rather than as a singular, coherent discourse in its own right. With its distinctive concern with functional representation, corporatism has been advocated by a wide range of social theorists, political activists and ideologues, and has been promoted for widely divergent reasons, interests and motives. Thus, at different times and in different contexts, it has been linked with Romantic organic theories of the state, pre-Marxist proto-socialism, social Christianity, fascist authoritarianism, secular modernizing nationalism, radical bourgeois solidarism, mystical universalism, internationalist functionalism, reactionary pseudo-Catholic integralism, technocratic pro-capitalist reformism, anti-capitalist syndicalism, guild socialism and communitarian socialism (Schmitter, 1979: 9-10). In this sense, corporatism has been articulated into many different political and ideological programmes and, by virtue of this articulation, changes its meaning and political significance. It can be a dominant theme in some periods and movements and a subordinate theme in others; moreover, even where it is significant discursively, the actual practices of self-described corporatist regimes

may depart significantly from the underlying ideologies and programmes.

Corporatism as functional representation

One way to analyse different types of corporatism is to consider how, if at all, they correspond to different stages in capitalist development or more specific economic and political conjunctures. Four broad phases can be distinguished in this context, with partial overlaps and survivals. This section deals only with corporatism in relatively advanced industrial societies in the nineteenth and twentieth centuries. Authoritarian corporatist states in less advanced industrial societies are discussed later.

Corporatism first emerged in modern Europe as a reactionary and utopian politico-ideological critique of liberal CAPITALISM. It reflected movements among feudal and traditional petty bourgeois classes (including artisans and yeoman farmers). Catholic and/or other religious groups, and traditional intellectual circles. Its adherents criticized the individualism, social disorganization and open class conflict that accompanied the rise and initial consolidation of liberal capitalism. Inspired in part by medieval occupational guilds and the old system of estate-based representation, they called for a restoration of social order through cooperation between professional and vocational associations. They hoped thereby to achieve the utopian goal of a universalistic, harmonistic state and society.

The second main version of corporatism was linked to 'organized capitalism' in the late nineteenth and early twentieth centuries. This version was not opposed to capitalism as such (which was now consolidated and had begun to develop monopolistic and imperialistic tendencies), but was more concerned about the revolutionary threat represented by organized labour. Thus it sought new forms of interest organization and/or societal regulation to defuse mass discontent and it proposed new institutional mechanisms and strategies for promoting politico-military and economic competitiveness. This version had both a

political dimension in efforts to replace class conflict with capital-labour cooperation and a more technocratic dimension concerned to overcome market anarchy through corporatist planning based on the passive co-option or the active concertation of producer interests. In inter-war Western Europe, this version of corporatism assumed both fascist (or corporativist) and social democratic forms; it acquired distinctive authoritarian populist forms in parts of Central Europe and Latin America, and it had transatlantic cousins in 'corporate liberalism' and the New Deal in the United States.

The third phase of corporatism saw the emergence of tripartism in the context of post-war Atlantic Fordism and its associated Keynesian national WELFARE STATES (see KEYNESIAN ECONOMICS). Emerging during post-war reconstruction in Europe as an alternative to fascism and to liberal capitalism, corporatism was supported by Christian democrats and one-nation conservatives, as well as by social democrats. It was revived again in some economies in the 1960s and 1970s in the hope of moderating emerging tendencies towards STAGFLATION. This form is often referred to by social and political scientists as 'neo-corporatism' to distinguish it positively from top-down fascist 'corporativism' and other authoritarian versions of corporatism. But early promises or hopes to the contrary, this neo-corporatist tripartitism has not always secured stable economic growth or promoted class collaboration. The crucial conditions for its successful operation seem to have included strong centralized industrial unions, strong centralized employers' unions, and a state with the right institutional and organizational capacities to manage the national economy but dependent on the cooperation of the so-called 'social partners' for their successful mobilization. In the absence of these preconditions, corporatist arrangements and strategies may still exist, but are less effective economically and conflict-prone politically. Even where it proved relatively successful, neo-corporatism was weakened by the crisis of Atlantic Fordism and the opening of national economies which

made effective national economic management harder and encouraged key capitals to seek to break with tripartism in favour of greater freedom for market forces. Nonetheless, neo-corporatism has survived in some places in more selective and meso- or micro-forms that privilege core workers and/or sunrise sectors at the expense of marginal workers and sunset sectors.

The fourth variant of corporatism became prominent in the 1980s and 1990s and is likely to expand further in the present decade. Though less often explicitly discussed in corporatist terms (in part due to the latter's negative association with the crises of the 1970s), there is interest in new forms of functional representation linked to new forms of capitalism. This is expressed in such terms as 'networking', 'public-private partnerships', 'strategic alliances', 'inter-organizational collaboration', 'regulated self-regulation', 'stake holding', 'productive solidarities', 'productivity coalitions', 'learning regions', 'the social economy' and 'associational democracy'. These different versions of contemporary corporatism share a concern with how best to govern complex open economies that are ill-suited to central planning but within which the unregulated market mechanism is still prone to fail. Moreover, as capital labour relations assume a less pivotal role in this variant of corporatism and greater emphasis is given to the role of extra-economic factors in securing competitiveness, the range of key participants (or relevant social partners) also expands. Thus more weight is given to the reflexive self-organization of economically relevant forces on different scales through mechanisms such as networking, negotiation, negative coordination (mutual self-restraint to avoid damaging the interests of those with whom one is interdependent) and positive coordination (to promote agreed joint projects). The scope of representation in this variant often extends to include many different functional interests (universities, local authorities, parties, scientific institutions and so on) and, in some circumstances, social movements rooted in CIVIL SOCIETY. Conversely, especially in its neo-

liberal subtype, organized labour tends to be marginalized or excluded from the new form of corporatism. Capital continues to play a key role in most of the partnerships, however, with the 'social economy' in its various forms being the principal exception. Finally, even where the state becomes one player among others in such corporatist negotiations or devolves decisions to other players, it often gets involved in setting the parameters and rules, defining acceptable outcomes and providing facilities for the reflexive self-organization of interdependent functional interests. Thus it plays a key role not only in corporatist governance but also in *meta-governance* – that is, the organization of the conditions of self-organization.

The recurrence of corporatism in capitalist societies, albeit in quite varied guises, is due to certain material features of such societies. These include: (1) the growing socialization of the forces of production despite continued private ownership of the means of production – which suggests the need for *ex ante* collaboration among producer groups to limit the anarchy of market forces, (2) the dilemmas posed by the shared interest of producer classes and groups in maximizing total revenues and the conflict over their allocation, (3) the contradictions posed by the institutional separation and mutual dependence of the economy and the state – which lead to different logics of economic and political action at the same time as they generate the need for consultation about the economic impact of state policies and the political repercussions of private economic decision-making – and (d) the problems generated by the nature of civil society as a sphere of particular interests as opposed to the state's supposed embodiment of universal interests – which indicates a need for some institutional means of mediating the particular and universal.

For obvious reasons, each of these four bases for corporatist arrangements is inherently contradictory. Thus they not only generate corporatist tendencies but also prompt instabilities in any emergent corporatist structures. Such problems are not unique to corporatism, however: there are analogous problems in other

forms of coordination or governance. This helps to explain the recurrent cycles of retreat from corporatism followed by its return in new guise. This pattern can be seen in corporatist policy cycles within given stages of capitalism and in the rise of new types of corporatism associated with different stages of capitalism.

Corporatism in political science and international political economy

The concept of corporatism was first used in its modern neo-corporatist sense shortly after World War II to describe economic and political patterns in contemporary Scandinavia. Interest in corporatism as an analytical concept in mainstream political science occurred largely in the 1970s and it then spread to international political economy (IPE) in the 1980s as a means of addressing issues of political regimes and their performance in economic crisis-management. The real paradigm shift in political science was largely provoked by a famous review article (Schmitter, 1979). The concept increasingly lost its pejorative association with fascist and authoritarian regimes, but its growing popularity also meant that the concept acquired multiple connotations and began to lose its analytical power through overextension. Almost all societies – developing as well as developed, state socialist as well as capitalist – have, at some time or another, been heralded as corporatist – either *tout court* or, more typically, in a qualified or hyphenated sense. This may well reflect intellectual fashion (especially in the 1970s and 1980s), but it also indicates the general significance of functional representation in complex modern societies.

Schmitter gave the following influential definition:

Corporatism can be defined as a system of interest representation in which the constituent units are organized into a limited number of singular, compulsory, noncompetitive, hierarchically ordered and functionally differentiated categories, recognized or licensed (if not created) by the state and

granted a deliberate representational monopoly within their respective categories in exchange for observing certain controls on their selection of leaders and articulation of demands and supports.

(Schmitter, 1979: 13)

He also contrasted two basic forms of corporatism, according to whether it was imposed from above or emerged through pressure from below. ‘Societal corporatism’ emerges from below as a form of economic crisis-management and of general economic and social bargaining. It is embedded in political systems with relatively autonomous multilayered territorial units, open competitive electoral processes and party systems, ideologically varied coalition-based governments, and is compatible with a plurality of social cleavages. In contrast, ‘statist corporatism’ is imposed by the state. It occurs in centralized bureaucratic systems, with purely plebiscitary or even non-existent elections, weak single-party systems, and inaccessible authorities with a limited recruitment base; and it often suppresses class, ethnic, linguistic and/or regional differences. Schmitter also suggested that societal corporatism is post-liberal, is well-suited to advanced capitalism and is associated with democratic welfare states; whereas state corporatism is anti-liberal, is usually associated with delayed capitalist development and forms part of an authoritarian neo-mercantilist state (see MERCANTILISM).

Interestingly, both societal and state forms (which are typically associated with the second and third phases of corporatism – see above) have been closely tied to, embedded in and supportive of a ‘structured coherence’ between national economy, national state and national society. Paradoxically, this can be associated with open economies as well as closed economies. In the former case, it is linked to horizontal cooperation to secure the supply-side conditions for international competitiveness and to share solidaristically the burdens of openness; in the latter case, it is linked to vertical coordination to promote national development plans, protect infant or declining

industries, engage in economic crisis-management, and/or control class conflict and distributional struggles. Thus internationalization or GLOBALIZATION, especially when it takes a liberal or neo-liberal form, tends to undermine the conditions for state corporatism, especially at the national scale. But there are at least two countertendencies at work here. The first is the increased importance of corporatism in support of positive, concerted, supply-side-oriented 'progressive competitiveness' (as opposed to a neo-liberal, deregulatory race to the bottom) and the more general defence of society against LAISSEZ-FAIRE capitalism (on the latter, see Polanyi, 1944). The second is the 're-scaling' of corporatism relative to the primacy of the national scale in the second and third phases of corporatism – whether upwards to supranational levels (a notable example being the EUROPEAN UNION (EU)), downwards to urban or regional levels (for example, public private partnerships for regional development) or sideways (the widening and deepening of various international economic regimes are good examples).

There is a strong tradition of state corporatism in semi-peripheral capitalist societies (see SEMI-PERIPHERY). This is evident in Southern Europe, Eastern and Central Europe, and Latin America before and after World War II (sometimes closely tied to populism or STATE SOCIALISM), as well as in the NEWLY INDUSTRIALIZING COUNTRIES (NICs) of East Asia from the 1970s onwards. Some authors have also argued that an autochthonous form of corporatism can be found in Africa, where it is based on the dissolution of the traditional peasantry, the weakness of civil society and the role of corporatist institutions in the extraction and redistribution of tribute (for example, Nyan'goro, 1986–7).

There are many other definitions of corporatism. For example, it has also been defined as a form of policy intermediation, a distinctive form of political economy, a distinctive type of state, a pattern of industrial relations, an emergent form of self-organization linking different societal spheres, a form of trade-union incorporation, a system of private-

interest government, and in other ways too. Indeed, there was a period in the 1970s and early 1980s when corporatism had become a buzzword with so many definitions that it became almost meaningless even when used in some compound form (for example, societal corporatism, statist corporatism, social democratic corporatism, meso-level corporatism, micro-corporatism) and served as a catch-all concept to bring together social scientists working on quite disparate topics.

After the initial conceptual proliferation, attention turned to the genesis, specificities and dynamics of different corporatist cases. It was argued that corporatism could exist on one or more levels of the economy (micro-, meso- and macro-); could be limited to specific sectors or provide the basis for concertation; need not be confined to the economy in a narrow sense but could extend into the welfare, health, education, scientific and other subsystems; could be linked to local, regional and supranational as well as national states; could be institutionalized or take the form of temporary strategies, and (in almost all of its many forms) tended towards instability. At the same time, increasing attention has been focused on the conditions that favour greater stability in corporatist arrangements (see previous section).

The discussion of political aspects of corporatism is also complex. Studies have shown that corporatism can compensate for parliamentary crisis or instability by reducing overload and/or mobilizing support; undermine the legitimacy of parliamentarism by providing alternative channels for interest intermediation and by-passing political parties; or function effectively only through close links to political parties, parliament and the administration. One broad point of agreement is that HEGEMONY is hard to secure through corporatist arrangements and that these must be supported through some other hegemonic and/or mass integrative apparatuses. It has also become clear that, as a political form, corporatism has no *a priori* consequences for the balance of forces; it is best seen as a structurally and/or strategically selective form of political organi-

zation whose specific effects turn on organizational, strategic and conjunctural factors.

Concluding remarks

Corporatism can be approached as a governance mechanism that is well-suited to situations of complex reciprocal interdependence, offering some advantages over the purely procedural rationality of market exchange and the more substantive rationality of top-down planning or imperative coordination. In this regard, it is often called on to compensate for MARKET FAILURE and/or state failure. But, like all forms of governance, it also has its own tendencies to failure. The relative success or failure of corporatism depends not only on its specific institutional form, but also on corporatist actors' ability to compensate for corporatism's own tendencies towards failure. These are partly structural and partly conjunctural. The same argument applies, of course, to markets and hierarchies. This explains the variable experience with corporatism, the multiplicity of its historical forms and its variability across apparently similar economies and societies, the cyclical nature of corporatist arrangements, and the tendency to reform, reinvent and rename it.

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BOB JESSOP

cosmopolitan values

Cosmopolitan values are rooted in the understanding that the individual belongs to an association that transcends the boundaries of any particular community, nation or state. A cosmopolitan stance is characterized by the often-cited phrase: 'I am a citizen of the world'. In order to grasp the varied values that are imparted with this proclamation, it is important to distinguish between two different cosmopolitan positions: political cosmopolitanism and ethical cosmopolitanism.

Political cosmopolitanism can be equated with the aspiration to global political institutions. Positions that fall within this category often champion the creation of a WORLD STATE. Such a stance advocates the elimination of political borders. However, one variation on this theme that has emerged at the close of the twentieth century amid the phenomena of increased GLOBALIZATION and the proliferation of liberal democratic regimes turns instead to the idea that citizens of any locality should be participants in democratic processes that extend beyond borders. This variation requires the transformation, rather than the elimination, of political borders. In both cases, the notion of world citizenship is meant quite literally.

Ethical cosmopolitanism embodies a sense of responsibility to humankind as a whole: the ultimate source of moral value lies outside any particular community; state boundaries have

cost, insurance, freight (c.i.f.)

merely derivative significance and can never be treated as moral watersheds, and individuals have obligations to their fellow human beings that cannot be overridden by loyalty to their compatriots. In this case, 'world citizen' is used metaphorically. These values are not tied to a particular global political structure and are often considered compatible with a system of discrete sovereign states. Nevertheless, as well as upholding notions of natural and human rights, ethical cosmopolitan values are invoked to support arguments for radical economic change, including the global redistribution of natural resources and wealth.

See also:

communitarian values; governance, global; transnational society

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articulation of political cosmopolitan values in a proposal for 'cosmopolitan democracy'.

TONI ERSKINE

cost, insurance, freight (c.i.f.)

Cost, insurance, freight (c.i.f.) is one of thirteen international commercial terms (INCOTERMS) developed by the INTERNATIONAL CHAMBER OF COMMERCE (ICC). It means that the seller must pay all costs and freight necessary to bring the goods to the named port of destination. This includes having to procure marine insurance against the buyer's risk of loss or damage to the goods during the carriage.

The term can only be used for sea or inland waterway transport. When the ship's rail serves no practical purpose, such as in container traffic, different INCOTERMS are more appropriate.

See also:

free on board (f.o.b.)

AXEL HÜLSEMEYER

cost-plus pricing

A method of price-setting in which a 'mark-up' is added to the average cost value in order to determine the final selling price. Business transactions are often undertaken using this system, due to its simplicity. There is evidence that suggests that 'mark-ups' are higher in markets where there is little competition between firms, compared to markets with a high degree of competition. Cost-plus pricing is often used in the PUBLIC SECTOR where contractors are permitted a specified 'mark-up', whatever their costs, although this has been criticized because it gives the contractor little incentive to minimize costs.

ALISON M.S. WATSON

Council for Mutual Economic Assistance (CMEA)

The Council for Mutual Economic Assistance (CMEA), or Comecon, was founded in January 1949 in Moscow and officially dismantled in September 1991. The CMEA was designed to coordinate economic relations between the socialist centrally planned economies (see **COMMAND ECONOMIES**). Its original members were Bulgaria, Czechoslovakia, Hungary, Poland, Romania and the Soviet Union. The CMEA was initially established largely to counter the United States' **MARSHALL PLAN** initiative of 1947. Soviet leader Josef Stalin aimed to establish a distinct Soviet-East European economic system, alienating Yugoslavia by excluding it from the CMEA. Albania joined the CMEA in 1949, but ceased to be a member in 1961. East Germany joined in 1950. The restriction that membership be limited to European communist countries was relaxed when the Basic Principles of the Socialist International Division of Labour were adopted in 1962, after which Mongolia (1962), Cuba (1972) and Vietnam (1978) were admitted.

Under the CMEA trading system, bilateral bargaining among member-governments fixed the character and quantities of goods to be traded during the next specified period. The prices of goods traded within the CMEA bore little resemblance to corresponding world market prices. For example, prices of fuel and non-fuel raw materials imported from the Soviet Union were often lower than world market prices, amounting in effect to Soviet **SUBSIDIES** to the other CMEA members. So-called 'transferable roubles' were created as an accounting unit to settle intra-CMEA transactions, which were recorded at the International Bank for Economic Cooperation (IBEC) from 1964. But transferable roubles were not only inconvertible into any international hard currency, they were not even entirely fungible within the CMEA. Their use for settling deficits with other members was at the discretion of IBEC, so there was incentive to avoid accumulation of a surplus of transferable

roubles. These preferential features of the CMEA's operations resulted in a highly politicized system, in which the other members' trade dependence on the Soviet Union enabled the latter to extract various forms of political and ideological compliance.

As individual member economies began to stall in the 1980s, intra-CMEA trade stagnated. The collapse of **COMMUNISM** in Eastern Europe in 1989 made the CMEA system even more anachronistic. The CMEA tried to transform itself by setting a January 1991 target for moving to hard-currency trading and the abandonment of centralized planning and direction. But trade within the CMEA kept shrinking and by 1990 the organization had effectively ceased to function. In June 1990, the nine members (East Germany left after reunification) met in Budapest to sign an agreement to dismantle the CMEA.

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HIROKO WAKAMATSU

Council of Ministers (European)

More properly known as the Council of the **EUROPEAN UNION (EU)**, this is the EU's most powerful institution. It sits in Brussels. It has both executive and legislative functions, and no EU legislation is produced without its acceptance. The Council is the means by which national governments of the member-states shape EU policy, having a rotating membership which alters according to the issue in question: ministers attend according to their portfolio. The Council Presidency is held by each member-state in turn for a period of six months, on a 'first among equals' basis. Although the **SINGLE EUROPEAN ACT (SEA)** (1987) provides for

countervailing duty

voting by qualified majority, the Council usually operates according to a culture of compromise, with the volume of package deals made to accommodate different national viewpoints far outweighing the number of issues put to the vote. Although the European INTEGRATION process has deepened considerably, the Council has not given way to the other EU institutions as many predicted. In fact, in two of the EU's three 'pillars' (the Common Foreign and Security Policy and the Police and Judicial Cooperation in Criminal Matters), the Council possesses almost all authority. In the first (and most advanced) pillar, however, the Council shares power with both the EUROPEAN COMMISSION and the European Parliament (EP), as well as the Court of Justice. Since the MAASTRICHT TREATY, many areas of first-pillar legislation are dealt with by the Council and Parliament on a roughly equal basis (the 'codecision' procedure). The Council is aided in its work by a set of highly influential Permanent Representatives (ambassadors) to the EU from each member-state, as well as a General Secretariat.

ALEX WARLEIGH

COUNCIL OF THE EUROPEAN UNION
see Council of Ministers (European)

COUNTERTRADE see international counter-trade

countervailing duty

A 'countervailing duty' is a variable duty added to subsidized imports that are below the market price. The duty is also intended to limit monopolistic activity (being levied on imported loss-leader products that are aimed at undermining the competition) and DUMPING (levied on surplus production disposed in foreign markets below its 'normal value' to maintain prices at home).

International and national trade laws are important in setting the restraints and limits on a duty to offset foreign subsidies.

See also:

tariffs; trade agreements

PAUL SHEERAN

country risk rating

Also referred to as SOVEREIGN RISK. 'country risk ratings' are judgements about the relative likelihood of INVESTMENT in a specified country generating a return and repayment of principal. Respected ratings are issued by the Economist Intelligence Unit, the trade journal *Institutional Investor* and a variety of less eminent sources. Similar in some ways to political risk analysis, but specifically designed for institutional investors, country risk rating has become more important as investors in lower interest-rate Western economies have sought higher yields in less well-known countries. At the very least, it offers investors and fund managers a way of demonstrating they are balancing the search for a higher return with the question of safety.

Sovereign risk is a subset of country risk. It refers to the specific issue of the creditworthiness of national governments to foreign creditors. Unlike other debtors, sovereigns (that is, governments) are not effectively constrained to repay debt, given their power to change laws, raise taxes and print money. Coming to a view on ability to pay must, therefore, be matched by an understanding of the willingness of the sovereign to pay. Sovereigns may decide to default, as Russia did in 1998, if they believe they can still attract investors in the future. A sovereign rating by one of the CREDIT RATING agencies acts as the limit (the sovereign ceiling) on the ratings of all other institutions in the country, premised on the superior tax-raising powers of the sovereign.

Country risk rating has had something of a bad press in recent years, because of a

perceived failure to anticipate the Asian financial crisis of the late 1990s (see *ASIAN CRISIS*). It remains an area where judgement is crucial, because the mixture of qualitative and quantitative variables is resistant to algorithms, especially the issue of willingness (as opposed to ability) to repay. Because of the potential for higher returns, country risk rating will continue to be a focus for analytical development among practitioners of global finance.

TIMOTHY J. SINCLAIR

Cox, Robert W(arburton) (1926–)

Of the many intellectual innovations by Robert W. Cox, three stand out as being of particular importance: (1) the distinction between problem-solving theory and critical theory, (2) modes of social relations of production and (3) a novel extension of the concept of *HEGEMONY* into the realm of global political economy. Cox's contributions to scholarship are not only about international relations (*IR*) or political economy, but also spring from social theory and historicism – the transcontinental traditions in which he is rooted. Indeed, Cox's work has an eclectic, original quality that defies attempts to classify it as neo-Marxist, neo-Gramscian or neo-Weberian (see *NEO-GRAMSCIANISM*; *NEO-MARXISM*; *NEO-WEBERIAN APPROACHES*); as a macro-theorist, Cox is an iconoclast who has not completely adopted any single conceptual scheme.

One of Cox's most compelling insights probes the focus and purposes of theory. He holds that two kinds of theory are related to two kinds of time. 'Problem-solving theory' is concerned with immediacy, takes the present as a given and seeks solutions to problems within that order. 'Critical theory' adopts a medium- and long-term perspective, probes how a political and economic order was formed, identifies changes within it and tries to shape those changes. Whereas problem-solving theory deals with proximate events and posits or assumes fixed parameters, critical theory is a more historical approach that attempts to

comprehend structural change. For Cox, the responsibility of the intellectual is to engage in critical thinking in order to offer a fresh perspective on the fundamental problems of a rapidly changing *WORLD ORDER*.

To explore world order, Cox introduced the concept of 'modes of social relations of production'. Self-consciously employing the method of *IDEAL TYPES* from *MAX WEBER* alongside the notion of historic bloc from *ANTONIO GRAMSCI*, Cox presents an elaborate classification intended to refine social class and political analysis through the categorization of different prototypes of social relations of production; in Cox's scheme, at least twelve patterns are identified. In other words, Cox builds an argument based on social forces, which is much broader than the Marxist concept of class. These are seen in relation to various forms of *STATE*. Cox distinguishes among the forms of state according to their institutional structure and links to *CIVIL SOCIETY*. These include the old-regime bureaucratic state, the liberal state, the welfare-nationalist state, the redistributive state, the neo-liberal state and the neo-mercantilist developmental state. This taxonomy also subsumes various subtypes and enables Cox to theorize about political economy in terms of production and *POWER*. Rejecting state-centric approaches, Cox emphasizes the fact that the coupling of state-civil society is integral to the ontology of global political economy. Above all, investigation of the combinations of state-civil society relations requires concrete historical analysis.

Thus far, we have identified two sets of Cox's major concepts: power and production, and the state and civil society, which are bridged by hegemony. Regarding the latter, Cox's idea of the 'form of state' refers not only to the institutional structure of the state but also the relations between state and civil society. This idea is drawn principally from Gramsci, who in fact wrote primarily about domestic political economy and had relatively little to say about *IR*. Preoccupied with explaining and struggling against Italian fascism under Benito Mussolini, Gramsci developed the notion of hegemony – a

credibility

configuration or moment when political life is characterized by a correspondence between political leadership and legitimacy, economic and institutional power, and a politics of consent (with COERCION always a factor in the mix). In a hegemonic constellation, ideas of leadership and the practical organization of society are fused in a project shared by members of social classes; that is, its appeal is inclusive and relatively universal. Gramsci honed these concepts in his analysis of the interface between Europe and Italy, with his starting point being the Holy Roman Empire and medieval European civilization. In this vein, Cox has taken Gramsci's concept of the historic bloc and extended it into the international and transnational spheres, and subsequently into the study of civilizations. In each case, Cox is searching, in a theoretical manner, for ways to explain the quality and the nature of politico-ethical and socioeconomic life, as well as the historical conditions that are leading to or might lead to global transformations.

Sets of social forces (ideas, institutions, material capabilities), forms of state and world orders come to characterize different historical epochs, some of which approximate hegemonic, or relatively stable, consensual orders (such as during the periods of Dutch, British and US hegemony). Nevertheless, hegemonic world-order structures are corporeal and transitory, and their conditions of existence are specific to particular periods. The post-war *PAX AMERICANA* encountered a period of organic crisis in the late 1960s and today, according to Cox, we have entered a post-hegemonic era. Thus Cox makes a case (in the vein of classical realists such as Niccolò Machiavelli), on one hand, that state civil society complexes (or forms of state) can be considered as basic units of analysis in global political economy; on the other, that new forms of authority from local to global levels will emerge from civil society, not only through CLASS FORMATION, but also through other identities such as GENDER, religion, race and ethnicity, and that these developments in civil society shape future

encounters and transformations of civilizations.

See also:

hegemony, bloc; hegemony, US; *Pax Britannica*

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JAMES H. MITTELMAN

credibility

To say a government's economic policies are 'credible' means that some group of people have confidence in (1) the truthfulness of policy statements, (2) the commitment to stand by those policies, and (3) the feasibility and sustainability of those policies. If economic agents (firms, consumers, lenders and so on)

doubt any of these, it will affect their expectations and decisions (for example, whether to buy or sell the currency of a country or invest in that country). If agents are also voters, then lack of credibility may lead them to vote against a governing party. If a government is thought to lack the political will to persist with unpopular policies, then those policies will be less credible. For a government to convince voters, for example, that it is serious about 'fighting INFLATION' may take time and be very costly in terms of higher unemployment – a problem highlighted in theories of the POLITICAL BUSINESS CYCLE.

Stress on the concept of policy credibility was a feature of theories of MACRO-ECONOMIC POLICY in the 1980s and has been applied to other policies – for example, to the LIBERALIZATION of trade policy, new more liberal policies to attract transnational corporations (TNCs), ideas justifying greater independence for central banks, evaluating institutional changes (as in the transition from communism to capitalism in Eastern Europe), explaining why some countries joined the EXCHANGE RATE MECHANISM (ERM), analysing the role of INTERNATIONAL MONETARY FUND (IMF) and WORLD BANK conditionality (see also CONDITIONALITY), and the increased role of CREDIT RATING agencies. A common theme in these applications is the importance of big business and the money markets in judging credibility, since they can 'move mountains' of money: a theme related to the STRUCTURAL POWER of capital and the NEW CONSTITUTIONALISM.

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DAVID LAW

credit

Credit plays an important role in the economy, at both micro-economic and macro-economic

levels, in allowing a more productive use to be made of the economy's savings and as the principal source of current spending power. Credit is the ability to transfer a future income stream to the present. It enables households, firms and the government to bring spending power forward to the current period in exchange for future repayments.

Firms and governments can borrow to invest and, by doing so, contribute to economic growth. Among households, both borrowers and lenders are able to increase their welfare by being able to come closer to their ideal time-pattern of consumption, with their success in this being dependent on the cost of credit and on how well the financial system works. Financial intermediaries and markets act to reduce the costs and risks faced by borrowers and lenders, and hence increase the benefits of saving and the ability of deficit units to obtain credit on suitable terms. If the financial system functions well, the funds accumulated by surplus units flow to the deficit units that are able to use them most productively, since the INTEREST RATE that borrowers are willing to pay should reflect the marginal benefit to the economy of an extra unit of investment. Sources of MARKET FAILURE, such as EXTERNALITIES and a lack of competition, lower the contribution of savings to economic growth and welfare. Indeed, a poorly functioning credit market might cause serious economic problems. For example, the problems faced by Japan in the late 1990s followed the extension by the banking system of large amounts of credit to bad risks. The consequent defaults placed the whole financial system under threat and damaged the real economy.

This illustrates a central problem: there must always be an element of uncertainty in credit markets. A variety of mechanisms operates to try to ensure that debtors meet payment obligations. These include legal provisions to allow the enforcement of credit contracts and the ability of financial institutions to prevent non-payers from obtaining credit in the future. In addition, the financial system discriminates between potential borrowers by including in INTEREST RATES a risk premium to reflect the

risk of a borrower defaulting on the loan. Nonetheless, there are significant parts of the credit market in which prices (rates of interest) are not able to change sufficiently to clear the market. Instead, credit rationing occurs. Some deficit units are not able to borrow at all. Others are offered a loan lower than the amount they wish to borrow and are not able to obtain a higher loan by offering to pay a higher rate of interest.

Until the 1960s, credit rationing was explained as a characteristic of short-run DISEQUILIBRIUM, resulting either from government controls on interest rates or from a failure of financial institutions to follow profit-maximizing rules. More recently, writers have argued that different loans carry differing degrees of risk. Furthermore, information about the degree of risk associated with loans is not only imperfect but also asymmetric. Potential borrowers have greater knowledge than the lender of the use to which the borrowed funds will be put. Indeed, borrowers have an incentive to understate the risks associated with their projects. Although lenders are aware that loans are not homogeneous, it may be best for them to act as if they were. However, if they seek to protect themselves by increasing the risk premium on all loans, they might simply discourage safer borrowers and increase the average degree of risk of their loans (adverse selection). In such circumstances, lenders might prefer to minimize risk by rationing new loans on a non-price basis (limiting loans to particular categories of borrowers, increasing collateral requirements, raising initial deposits or shortening maximum repayment periods). That is, credit rationing might be a rational response to uncertainty rather than a disequilibrium phenomenon.

Credit provides the major element in immediate spending power, which consists of holdings of money and other liquid assets, and the ability to borrow. The significance of credit in macro-economics derives from the Keynesian proposition that, in an uncertain world, expenditure plans are crucial in the determination of the output and employment levels of an economy (see KEYNESIAN ECO-

NOMICS). An economy can only be in equilibrium if spending plans match the production plans of firms, and (in the making of plans) it is people's *access* to MONEY that is important rather than their current holdings of money. It follows that a monetary authority wishing to control expenditure within an economy should be more interested in total potential spending power than in the various possible measures of the money supply. This was at the heart of the availability doctrine which was widely accepted by Keynesians in the 1950s. It held that demand deficiency (and hence unemployment) could arise in an economy because credit was rationed. But since credit rationing was associated with disequilibrium, the idea lost popularity from the 1970s onwards with the return to dominance of equilibrium economics. However, the later explanations of credit rationing based on asymmetric information brought the availability doctrine back to life.

This new approach had an important message for monetary authorities. A tight monetary policy based on increases in the rate of interest might bring about an increase in the average riskiness of lending and in the level of defaults on loans. Thus, the deflationary impact of a tight monetary policy might be very great and difficult to control. This formed part of the explanation for the depth of the recession in the United Kingdom in the early 1990s.

Credit has also been of great importance at an international level. The poorest countries are frequently unable to obtain credit. The DEBT CRISIS OF DEVELOPING COUNTRIES of the 1980s and 1990s provided disturbing examples of savings not flowing to their most productive use and of the damage that a malfunctioning financial system can do to real economies. In addition, it made clear the potential risk to financial systems from major defaults on payment obligations.

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KEITH BAIN

credit allocation

How CREDIT is distributed is an important issue within the study of international political economy (IPE). Traditionally, commercial banks made loans to enterprises secured by assets that would be forfeited should the loan not be repaid. Within this traditional model, there was much local variation. In Germany, banks would take an active role in the ownership and management of the corporations to whom they lent money. Allocation could then be undertaken with a great deal of information and with less anxiety about short-term returns to the investment. In England, the City of London (see LONDON, CITY OF) was less concerned with financing local enterprises than with higher return international lending. In the United States, laws have sought to divide banking and corporate entities. The point is that entirely different institutional networks evolved based on variations in how credit was allocated.

In the last twenty years or so, these traditional bank-based models of credit allocation – founded on a multitude of institutions making allocation decisions – has been subject to competition from disintermediated systems. In traditional credit allocation, the intermediary (bank) shoulders the risk of bad loans. But intermediation is expensive, as the costs of the bank (and the failed loans) have to be passed on to those seeking credit. With GLOBALIZATION placing a premium on costs, borrowers have sought cheaper alternatives. One alternative has been to obtain credit from the capital markets by selling SECURITIES.

This change in the form of credit allocation raises important questions about the institutional reorganization of the global economy. Will such a system reduce the number and

severity of financial crises? Will the new model of credit allocation take different forms in different countries, or will we see less institutional variation than in the past?

See also:

capital; disintermediation

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TIMOTHY J. SINCLAIR

credit rating

For a long time a quiet backroom activity, credit rating became an important public issue in US finance during the 1980s when Michael Milken and others were instrumental in the establishment of a high-yield or junk bond market for lower-rated corporations. This development was a feature of the broader process of DISINTERMEDIATION. During the 1990s, credit rating became central to the financing of national BUDGET DEFICITS and governments put great effort into securing higher ratings. Also during the 1990s, awareness of the personal implications of credit rating grew significantly and it became hard to get a good job or a place to live without a reasonable credit rating.

In abstract terms, credit rating amounts to an estimation of the probability that a borrower will repay their debts as contracted. For the most part, the rating is concerned with ability to pay, but where the rating concerns a sovereign government it also, given the law-making powers of states, incorporates the issue of willingness to pay. Credit raters insist that

criminal economy

what they do is assess just one variable among the large number involved in any decision to buy SECURITIES. However, credit ratings certainly do provide a ready way for investors to distinguish financial instruments from one another and it may be that ratings have acquired more power than intended by their creators. Controversy still rages about whether the agencies actually contribute new information to the markets. Even if they do not, governments, corporations and other market participants often behave as if they do.

Two major firms dominate the business in wholesale credit rating. Both based in New York, Moody's Investors Service and Standard & Poor issue ratings on around US\$15 trillion worth of securities. With between 1,200 and 1,500 employees each, these agencies dwarf their nearest rivals. Competition in the rating business is, however, developing at a fast pace, with the merger between second-tier firms Fitch IBCA and Duff and Phelps, and rumours about a new pan-European agency financed from Germany. There are many minor rating agencies in emerging markets. Most of these, however, suffer perceived conflicts of interest because of their association with local financial institutions and governments. Their reform may be a key advance in the creation of a NEW INTERNATIONAL FINANCIAL ARCHITECTURE.

Credit-rating agencies are frequently criticized by financial market agents for being too slow to react to change. That was the view in the mid-1970s during the New York City financial crisis and again in the 1997 Asian financial crisis (see ASIAN CRISIS). The most recent crisis has, however, changed the internal culture of one of the major US agencies, which had been known for its closed and secretive nature.

Less well understood are the implications of credit rating for distributional issues, CREDIT ALLOCATION and the diversity of economic and political institutions.

Despite the criticism credit-rating agencies have suffered in recent years, credit rating is likely to become more rather than less important in future. With the realization among many regulators that government-imposed

standards have little chance of success in today's fast-moving markets, there is renewed interest in developing credit rating as a regulating mechanism within the capital markets.

See also:

capital mobility; securitization

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TIMOTHY J. SINCLAIR

criminal economy

The activities usually associated with the criminal economy are the drugs trade, extortion, illegal gambling, tax evasion and large-scale theft devised by organized criminal groups. The significance of criminal economies is that the wealth generated by these activities is used to buy popular and political support in the local communities. This can create constituencies with a vested interest in the continued existence of the groups responsible for such activities.

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KEITH MAGUIRE

crisis, global economic

Although there have been major financial crises affecting the performance of the global economy from the time of the collapse of the speculative South Sea Bubble in 1720 (see BUBBLES), the phenomenon of and potential for global economic crises has been most marked during the twentieth century. This potential has derived in large part from the increasing INTEGRATION of financial markets and the fact that modern information and communications technology permit panic and mania to be transmitted almost instantaneously from one market to another through a variety of routes: examples include short-term movements in CAPITAL OR INTEREST RATES, fluctuations in commodity markets, or simple psychological infection. A distinctive feature of the two major global financial crashes of the twentieth century, the Great Crash of 1929 and the BLACK MONDAY stock market crash of October 1987, has been that all major stock markets have crashed simultaneously, even though a relatively small number of securities were truly international – that is, being traded on several markets (Kindleberger, 1989: 131–2).

The most severe peacetime global economic crisis of the twentieth century arose following the Great Crash of stock markets in 1929, itself the product of a prolonged period of speculative trading in financial markets. The Great Crash then ushered in the GREAT DEPRESSION, a period of deep economic recession during the 1930s, from which it took the major capitalist economies fully ten years to recover. For example, following the Wall Street Crash of 1929, the GROSS NATIONAL PRODUCT (GNP) of

the US economy fell in 1933 to a third of its 1929 level. It was not until 1941 that the dollar value of US production recovered to its pre-Crash levels. Indeed, during the 1930s, US unemployment – which had risen to a record 13 million in 1933 (about 25 per cent of the labour force) – only once (1937) fell below 8 million (Galbraith, 1980: 168).

The potential for an economic crisis to envelop the global economy has been raised most frequently in Marxist political economy. KARL MARX argued that CAPITALISM would be subject to inevitable and periodic crises of OVERPRODUCTION of commodities for which there would be no buyers. These crises would result in a spiral of unemployment among workers and bankruptcies among businesses, which would in turn set in motion a further collapse in the demand for consumer goods. The resulting contracted reproduction would eventually create a situation where production would have contracted more than the available purchasing power among consumers. Therefore, output would be able to start to recover to meet that demand and profits would start to recover, thereby triggering a new wave of investment and employment which would in turn set in motion a new cycle of capitalist expansion. However, that expansion itself would inevitably lead to its own crisis of overproduction and the next economic crisis would ensue (Mandel, 1987: 380).

Marx did not explain economic crises in terms of excessive wage demands arising from the working class (see CLASS, WORKING) or their trade union representatives. For Marx, crises arose because of the failure of the rate of increase of SURPLUS VALUE to keep pace with the rate of increase of the organic composition of capital. This failure would be manifested in a FALLING RATE OF PROFIT (FRP) that would then trigger an economic crisis. Furthermore, if workers' wages failed to increase during periods of economic expansion, but duly contracted during periods of recession, the overall effect over the economic cycle would be to enhance the overproduction of goods, which would result in an even more pronounced collapse in output, employment and investment,

and therefore a more severe economic crisis (ibid.: 381).

It is unclear as to whether Marx thought that the inevitability of economic crises under capitalism would lead to capitalism's final collapse. Marx argued that economic crisis, together with the centralization of capital, would provide the conditions required to overthrow capitalism, but whether capitalism was duly overthrown would in turn depend on whether the increasing EXPLOITATION of the working class then resulted in political and social revolution. Similar uncertainty surrounds the question of whether a global economic crisis might arise in the post-capitalist society envisaged by Marx. His contention was that post-capitalist society would pass through stages of economic organization. During the first stage, which Marx called 'SOCIALISM', because of a relative scarcity of consumer goods and services, it would be necessary to precisely calculate distribution on the basis of each individual worker's actual labour inputs. During the second stage, which Marx called 'COMMUNISM', consumer goods and services would be in plentiful supply, creating a utopian society of producers' and consumers' communes (ibid.: 382). From a Marxist perspective, in such circumstances a global economic crisis would be unlikely to arise.

The threat of a global economic crisis has emanated most frequently from financial crises. The INTERNATIONAL MONETARY FUND (IMF) has identified four types of financial crisis. First, a currency crisis occurs when:

a speculative attack on the exchange value of a currency results in a devaluation (or sharp depreciation) of the currency, or forces the authorities to defend the currency by expending large volumes of international reserves or by sharply raising interest rates.

Second, a banking crisis occurs when:

actual or potential bank runs or failures induce banks to suspend the internal convertibility of their liabilities or ... [compel] the government to intervene to prevent this

by extending assistance on a large scale. A banking crisis may be so extensive as to assume systemic proportions.

Third, systemic financial crises are those that pose:

potentially severe disruptions of financial markets that, by impairing markets' ability to function effectively, can have large adverse effects on the real economy. A systemic financial crisis may involve a currency crisis, but a currency crisis does not necessarily involve serious disruption of the domestic payments system and thus may not amount to a systemic financial crisis.

Fourth, a foreign debt crisis is 'a situation in which a country cannot service its foreign debt, whether sovereign or private' (IMF, 1997: 74-5).

Financial crises are associated with the peaks of BUSINESS CYCLES, when the culmination of a period of expansion leads to a downturn. CHARLES KINDLEBERGER has sought to identify a theory to explain crashes (that is, a collapse in the price of assets, or the failure of an important bank or firm) and panics (that is, a sudden fright without cause in asset markets). Financial crises 'may involve one or both, and in any order' (Kindleberger, 1989: 126). Past financial crises in the international economy have tended to commence with a displacement – that is, an exogenous, external shock to the macro-economy resulting from, for example, the outbreak or end of a war, an industrial revolution triggered by new technologies, a bumper harvest or famine, or a political event. Kindleberger's thesis is that neither Keynesian nor monetarist theories (see KEYNESIAN ECONOMICS; MONETARISM) have been able to account for economic crises because they have tended to omit 'the instability of expectations, speculation, and credit and the role of leveraged speculation in various assets' (ibid.: 25). Another facet of a crisis is distress – that is, a state of suffering on the part of commerce and finance and/or an economically hazardous situation. For example, distress lasted from June to the last week of October

during the 1929 financial crisis and from early August to mid-October during the 1987 stock market crash (ibid.: 120). Kindleberger's model of financial crises has suggested that displacement, euphoria and distress have tended to be followed by speculative mania, panic and a possible crash.

While economic theory tends to assume that most markets generally behave rationally, an economic crisis may be triggered when RATIONAL EXPECTATIONS are displaced or replaced by mania or speculative excess in financial markets – that is, getting out of touch with reality or rationality. Indeed, on occasions the rational actions of individual investors to withdraw their investments suddenly from a falling market may result in a destabilization that is irrational overall (ibid.: 28). Speculative manias have tended to gather momentum through an expansion of money and credit which is systematic and endogenous rather than random and exogenous (ibid.: 59). Although central banks have been established to impose control on the instability of credit provided by the private banking system, on occasions an absence of control has resulted in an economic crisis. This results from a situation in which the interests of banks as profit seekers, which has led them to extend further credit to fuel a speculative boom, have conflicted with their role as depositories for savings which they have been entrusted to safeguard against INFLATION.

With the growth of computerized trading in increasingly liberalized financial markets and the onset of financial crises in certain of the previously high performing economies of East and South-East Asia, forecasts of global economic crisis have emanated from some of the most prominent advocates and successful exponents of capitalism, rather than from some of its severest critics. For example, although such financial crises are neither a novel nor a recent phenomenon, the IMF has suggested that their spill-over effects and propensity for contagion now seem to be far more pronounced and far reaching (IMF, 1998: 74). For his part, George Soros, the billionaire

exponent of speculative trading in financial markets, has suggested that:

The world is in the grip of an acute financial and political crisis. This crisis, if left unchecked, will lead to the disintegration of the global capitalist system. It is a crisis that will permanently transform the world's attitude toward capitalism and free markets. It has already overturned some of the world's longest established, and seemingly immovable, political regimes. Its effects on the relationships between advanced and developing nations are likely to be permanent and profound.

(Soros, 1999: 55)

Indeed, Soros has described the Asian financial crisis as 'particularly unnerving because of its scope and severity' (Soros, 1998: 135; see ASIAN CRISIS). In his judgement, the crisis is nothing less than 'a symptom of pathologies inherent in the global system' which have now confronted the ideology of world capitalism with a historic challenge (Soros, 1999: 56–7).

There were indeed flaws in the Asian model of economic development: namely,

structural weaknesses in the banking system and in the ownership of enterprises, the incestuous relationship between business and politics, the lack of transparency, and the absence of political freedom.

(Soros, 1998: 140)

However, for Soros, the major cause of the Asian financial crisis was not internal or domestic, but external: namely, the nature of the international financial system itself. Soros' analysis of the causes and consequences of financial crises is based on a critique of the global capitalist system which in turn rests on a rejection of what he terms 'market fundamentalism' – that is, the belief that financial markets, left to their own devices, tend towards equilibrium. In his opinion, financial markets are inherently unstable, for 'Instead of acting like a pendulum, financial markets have recently acted more like a wrecking ball, knocking over one economy after another' (ibid.:

xvi). Because they do not passively reflect reality, but actively create the reality that they, in turn, reflect, the reflexivity of financial markets ensures that they are inherently unstable and therefore the potential for global economic crisis is a constant threat.

This analysis is premised on Soros' own market-trading experience and belief that 'financial markets cannot possibly discount the future correctly because they do not merely discount the future; they help to shape it' (Soros, 1995: 311). The consequence is that financial markets tend to be dominated by trend-following behaviour that may not only affect the very so-called 'macro-economic fundamentals' which investors are supposed to be following, but also induce violent market crashes. Because the performance of institutional investors (the major actors in financial markets) is normally measured relative to the performance of their peers, they tend to follow market trends. For Soros, the free rein of market forces will not address certain social, moral and political considerations, not least the expression of common interests. This is because the profit-maximizing behaviour characteristic of financial markets is driven by 'the dictates of expediency and ignores the demands of morality', thereby rendering markets amoral rather than immoral (Soros, 1998: 205, 208). The IMF's aim to impose market discipline is therefore inappropriate, because it will mean the imposition of instability. Market discipline must be supplemented by another discipline: namely, the maintenance of stability in financial markets.

The failure of the IMF reflects Soros' assertion that the failings of the market are insignificant when compared with the shortcomings of the non-market sector of society. Soros contends that political leaders have embraced the prevailing ideology of market fundamentalism, or untrammelled individualism, which has acted as a form of 'ideological imperialism' in emerging markets (ibid.: xxv). Market fundamentalism has sought 'to abolish collective decision making and to impose the supremacy of market values over all political and social values' (ibid.: xxvii viii). A new

balance between politics and markets is now urgently required because the Asian financial crisis has undermined the capacity of the international financial authorities to prevent and resolve financial crises. Some form of global political decision-making must be established to stabilize and regulate the global economy.

Greater transparency in itself will not resolve the Asian financial crisis. For Soros, the urgent need is to reverse the flow of capital from the periphery to the centre that threatens to cause mutually reinforcing economic contraction in both and which might deliver a severe global DEPRESSION. Soros' proposal is the creation of an International Credit Insurance Corporation to guarantee major loans to the crisis economies as a means of engendering confidence among international investors. The credit guarantees should be distributed through authorized private banks, which would compete with each other. As a remedy for FLOATING EXCHANGE RATES, which Soros contends are inherently unstable because of the propensity for trend-following SPECULATION, he proposes the establishment of single currencies in the single markets or the introduction of currency boards – that is, automatic mechanisms to issue and withdraw local currency when the equivalent amount of reserve currency is deposited with or removed from the currency board. Soros also argues that FINANCIAL INNOVATIONS that create instability should be viewed in a different light to the other innovations generated by open markets. Therefore, he suggests that DERIVATIVES and other synthetic financial instruments 'perhaps' should be licensed in a similar manner to that in which new issues of securities in the United States have to be registered with the Securities and Exchange Commission (ibid.: 183–5, 190). As for CAPITAL CONTROLS, Soros does concede that some form of capital controls may be preferable to instability, given that 'short-term capital movements probably do more harm than good'. In overall terms, Soros' message is clear: 'Financial markets are inherently unstable; they need supervision and regulation' (ibid.: 193–4).

The Asian financial crisis has been damaging and may yet be more damaging for the performance of the world economy. It has been noted that:

The Thai crisis of July 1997 soon became the Southeast Asian crisis, then became the Asian crisis in October and, for a period, the Great Asian Depression.

(Wade and Veneroso, 1998a: 14)

It threatened to translate into a global economic crisis, especially if there was to be a correction to the seemingly overvalued US stock market or protectionist trade measures were initiated to counteract the rapidly deteriorating US current account. Indeed, the US economy could still be vulnerable to a sudden outflow of capital, given its BALANCE OF PAYMENTS deficit. With the lowest aggregate savings rate in the ORGANISATION FOR ECONOMIC CO-OPERATION AND DEVELOPMENT (OECD), the US economy depends on foreign capital to finance its investment and consumption. A sudden withdrawal of that capital would have detrimental multiplier effects on investment and consumption, not just in a domestic but also in a global context, and could trigger an economic crisis.

Wade and Veneroso have neatly summed up the potentially explosive consequences for the global economy of the Asian financial crisis in their equation 'Deflation + debt + highly integrated international financial markets = dynamite' (ibid.: 17). As Radelet and Sachs have suggested, when a financial crisis occurs, blame tends to be attributed to the debtors, even if the failure of a loan involves two parties (Radelet and Sachs, 1998: 1). Thus responsibility for the Asian financial crisis has been attributed to the inherent flaws of East Asian capitalism in general and East Asian financial markets in particular. However, because the East Asian economies had previously been the basis for a successful model of capitalist development and the crisis itself was largely unanticipated, not least by foreign investors in the region, Radelet and Sachs have sought an alternative explanation for the Asian financial

crisis. Their contention is that recent financial crises in Latin America and East Asia have displayed 'elements of a self-fulfilling crisis, in which capital withdrawals by creditors cascade into a financial panic and result in an unnecessarily deep contraction'. Thus, given the intrinsically highly unstable nature of international financial markets, it must be acknowledged that the East Asian crisis 'is as much a crisis of Western capitalism as of Asian capitalism' (ibid.: 2-3). Furthermore, although several international macro-economic shocks hit the East Asian economies during 1994-6, Radelet and Sachs contend that the impact of these external factors was modest, but their interaction with growing weaknesses in East Asian financial systems provoked the financial crisis. These weaknesses had arisen from a process of partial financial sector LIBERALIZATION and reform, which had resulted in 'growing short-term foreign debt, rapidly expanding bank credit, and inadequate regulation and supervision of financial institutions' (op. cit.). As a consequence, the East Asian economies were vulnerable to the impact of a rapid reversal of capital flows - from a net private inflow of US\$93 billion in 1996 to a net outflow of US\$12.1 billion in 1997.

Radelet and Sachs contend that there are three broad categories of explanation for the East Asian financial crisis: namely, 'shifts in international market conditions; growing weaknesses and mismanagement in the Asian economies; and instabilities intrinsic to the international capital markets' (ibid.: 29). Their contention is that while the first two categories of explanation can only partly account for the crisis, it is intrinsic capital market instability which provides the key factor for understanding the depth, severity, extent and simultaneity of the crisis in the five East Asian economies. In terms of changes in international market conditions, the effects of a collapse in export growth in the face of a new global glut of labour-intensive manufactured exports from China and Mexico may be discounted as only modest - especially when compared with the impact of international market conditions on Latin America during the 1980s. In terms of

growing weaknesses and mismanagement in the Asian economies, the contention that there were deep flaws in Asian capitalism is somewhat undermined by the fact that the crisis was unanticipated. One might have expected such deep flaws to be evident either to domestic policy-makers or international investors. Furthermore, Radelet and Sachs suggest that the real problem was not one of MORAL HAZARD arising from investors' perception that they would be bailed out by the IMF in the eventuality of a crisis. Rather, the problem was that foreign investors devoted insufficient thought to the risks associated with their substantial investments in East Asia, because they were seduced by the prospect of a continuation of rapid growth and high profitability (ibid.: 42).

Identifying the most appropriate response to financial crises raises the dilemma of whether financial markets should be left to resolve their difficulties, given that it was their own risk-taking and search for profit that caused the crisis in the first place, or whether the desire to avert the threat of deflationary panic spreading to the macro-economy should legitimize public intervention. The fact that financial crises have tended to trigger intervention points to the latter. In such circumstances, a LENDER OF LAST RESORT (once identified) has faced its own general dilemma of when and how to intervene, and in particular how much to lend, to whom and on what terms. Despite the intervention of a succession of lenders of last resort, including the IMF, in financial crises from the South Sea Bubble of 1720 to the Asian financial crisis of 1997, Kindleberger has concluded that the aftermath of an economic crisis has depended not only on how the crisis was managed, but also on

a host of other variables, especially the factors affecting long-term investment: population growth, the existence of a frontier, demands arising from war, exports, the presence or absence of innovations that are not fully exploited, and the like.

(Kindleberger, 1989: 232)

Therefore, the presence of a lender of last resort may not in itself be a sufficient condition to avoid an economic recession or depression in the world market, as the aftermath of the IMF's intervention in the Asian financial crisis has demonstrated.

In its May 1998 *World Economic Outlook*, the IMF suggested that the Asian financial crisis was partly attributable to the very success of the high-performing Asian economies, which had led foreign investors to underestimate these economies' actual weaknesses. At the same time, the rapid financial inflows to these economies had outpaced the development of appropriate policies and institutions (IMF, 1998: 3). Wade and Veneroso have contended that the IMF has used the Asian financial crisis as a weapon for imposing conditions on the Asian debtor economies, with the objective of forcing them to abandon their high-debt model of development in favour of a Western system of open financial markets which will in turn 'preclude many of the policies of the developmental state' (Wade and Veneroso, 1998b: 31). Radelet and Sachs have drawn a dividing line between the IMF's response to the Asian financial crisis before and after the 24 December 1997. Prior to that date, from August 1997, the IMF had assembled an unprecedented total of US\$109 billion of international financial support for Thailand (US\$17 billion), Indonesia (US\$35 billion) and South Korea (US\$57 billion). In practice, the amount of actual funding made immediately available to address short-term illiquidity problems was substantially smaller than the gross sum, given that it was to be disbursed over a three-year period. The IMF's immediate objective was to restore financial market confidence, primarily through stabilization of the recipient countries' respective exchange rates. However, the effect of providing central banks with the capacity to service short-term debt repayment was to socialize the original private loans. In effect, foreign creditors and private banks were allowed to escape the crisis without having to share in the financial losses by rescheduling their loans. Instead, that responsibility was to be solely

borne by the foreign exchange reserves of the crisis economies' governments.

For Soros, the Asian financial crisis reflected a systemic problem in which 'the IMF is part of the problem, not part of the solution' (Soros, 1998: 148). The Asian financial crisis presented the IMF with two major problems. The first problem was the very complexity of the crisis. It had both a currency and credit component, with the latter in turn possessing both a domestic and international dimension. All these components were themselves interrelated (ibid.: 146). The second problem confronting the IMF was the fact that this crisis, unlike previous financial crises, had originated in the private sector against the context of very healthy public finances among the Asian economies. When the IMF sought to restore market confidence, its policy prescriptions failed because they addressed only some but not all aspects of the crisis. In particular, the IMF failed to address the debt problem that was the key, in turn, to restoring currency stability. Furthermore, for Soros, the liquidity crises experienced by the Asian economies reflected structural imbalances which could not be left unattended. The solution to the Asian financial crisis was not simply for the IMF to lend the crisis economies more money. The high levels of debt in the Asian economies had to be reduced by their conversion to equity (ibid.: 147-8).

For their part, Wade and Veneroso have indicated their own broad agreement with the necessity for some form of capital controls in Asia and that – with the notable exception of Japan – these should take the form of semi-permanent controls on capital inflows (Wade and Veneroso, 1998b: 30). There are two principal justifications for this challenge to the cult of capital liberalization. First, Asian economies must guard themselves against excessive and destabilizing short-term capital inflows in the future. While they may need short-term foreign capital inflows to refinance their foreign loans and foreign technology, capital equipment and expertise, the crisis economies do not need short-term capital to finance investment, given that they have the

highest savings rates in the world. Second, capital controls are needed to restore stable growth, especially in those economies characterized by high corporate debt-to-equity ratios, where the possession of sound macro-economic 'fundamentals' has not been sufficient to stave off financial crisis (ibid.: 30-1).

The onset of the Asian financial crisis has also raised fundamental questions for those politicians and officials responsible for the governance of financial markets, if the possibility of global economic crisis is to be avoided. The US Treasury Secretary, Robert Rubin, has suggested that the world economy 'cannot live with the kind of vast and systemic disruptions' of recent years, and therefore has advocated reforms which he has asserted must be as profound as those implemented in the 1930s (*Financial Times*, 2 October 1998). In his view, action must be taken to increase the openness in the international financial system; to strengthen national financial systems, especially in emerging economies; to create more soundly based capital flows in the industrialized economies, and to identify new ways to respond to financial crises, including a larger role for private financial institutions in rescue packages. Subsequently, the GROUP OF 7 (G-7) industrial economies has drawn up a global action plan to restore confidence in international financial markets, including a US\$90 billion 'contingency' fund to enable rescue packages to be quickly assembled for countries with economies in fundamentally sound order that are nonetheless facing short-term difficulties. However, the principle of using taxpayers' money to rescue private financial institutions has not been universally welcomed. While the widespread bank failures in the United States in the 1930s cost little more than 4 per cent of GROSS DOMESTIC PRODUCT (GDP) to remedy, certain emerging economies have recently been faced with the problem of transferring 25 per cent of their GDP to rescue packages for private banks (*The Independent*, 16 November 1998). Given the calamitous consequences of such transfers for development, both in the short and longer term, the possibility of tighter controls on capital (especially speculative

short-term movements) is now being widely advocated.

Wade and Veneroso have identified the central role played by capital account liberalization during the 1990s in the Asian financial crisis. Thus, the sudden switch from net private inflow to net private outflow in the five crisis economies amounted to 11 per cent of their combined GDP between 1996 and 1997 (Wade and Veneroso, 1998b: 20). The resulting policy backlash has been a movement towards capital controls in Hong Kong, Malaysia, South Korea and Taiwan. Indeed, Wade and Veneroso have asserted that 'capital curbs are an idea whose time has returned, in the minds of many Asian government officials' (ibid.: 27). This is a remedy for the crisis which has extended beyond East Asia. For example, Paul Krugman has advocated the 'unsayable words', namely 'exchange controls' (Krugman, 1998: 31). His contention is that the IMF's prescription failed because its insistence on cuts in government spending and increases in taxation merely inspired 'a gratuitous deflationary policy that worsened the recession' (ibid.: 30). Exchange controls must be introduced on a temporary basis to enable the link between domestic interest rates and the exchange rate to be forcibly broken. In continental Europe as well, the idea of some form of capital controls is no longer anathema. The French Prime Minister Lionel Jospin has contended that: 'The crises we have witnessed teach us three things: capitalism remains unstable, the economy is political, and the global economy calls for regulation' (cited in Wade and Veneroso, 1998b: 29).

See also:

financial integration; financial panics and crises

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Critical analysis and restatement of the case for the reintroduction of capital controls.

SIMON LEE

crisis of world capitalism

Counter to the expectations and promises of mainstream economic theory, the global extension of capitalism has not brought stable growth, generalized prosperity, and the CONVERGENCE of income and development levels among countries. In the long run, the capitalist world economy is crisis-prone and unequal.

An increasing feeling of malaise and crisis is the outcome of two decades of neo-liberal policies (see NEO-LIBERALISM). This is not only the case in the majority of underdeveloped countries in the THIRD WORLD and Eastern Europe, but also in relatively more successful emerging markets such as the 'Asian Tigers' (see FOUR TIGERS (ASIAN)) and Brazil, as well as in Japan and the EUROPEAN UNION (EU). The ideological and social crisis of the current WORLD ORDER has distinct material roots.

In the Third World, almost 3 billion people (the majority of the Third World's population) dispose of less than one dollar per day. Some 1,300 million women, men and children live in absolute poverty with less than a dollar per day. Roughly the same number is homeless and roughly the same number has no access to education or to medical care. Every year, 30 million people (mainly children) die of hunger, while 800 million suffer from chronic malnutrition. This situation is not about to improve, as long as many Third World countries are economically strangled by debts which are not – or only marginally – declining, since it is very difficult or even impossible for them even to pay the debt service. Many countries have already more than repaid their original loans through interest payments. But substantial programmes for the cancellation of the Third World debt, as proposed by NON-GOVERNMENTAL ORGANIZATIONS (NGOs) in the SOUTH and the North, have nevertheless not been drawn up by the INTERNATIONAL MONETARY FUND

(IMF) or ORGANISATION FOR ECONOMIC CO-OPERATION AND DEVELOPMENT (OECD) countries.

Economic and social conditions have worsened for much of the world population since the end of the 1970s. In fact, the distance between rich and poor has increased, and world capitalism is characterized by increasing inequality. According to figures from the UNITED NATIONS DEVELOPMENT PROGRAMME (UNDP), the 20 per cent of the world's population living in the richest countries earned an income in 1960 which was 30 times higher to that of the poorest 20 per cent; in 1995 their income was 82 times higher. The 2 billion poorest people in the world, living on US\$350 or less per year, saw their share in the world's global product decline from 4.2 per cent in 1980 to 2.5 per cent in 1997.

That this growing impoverishment of a large part of the world population is not inevitable can be seen from the fact that there are not only losers, but also big winners in today's world economy. Never before in history was so much wealth concentrated in so few hands. As the UNDP notes in its *Human Development Report 1998*, with only a small percentage of this wealth universal access to social services for all could be guaranteed:

New estimates show that the world's 225 richest people have a combined wealth of over \$1 trillion, equal to the annual income of the poorest 47% of the world's people (2.5 billion) ... It is estimated that the additional cost of achieving and maintaining universal access to basic education for all, basic health care for all, reproductive health care for all women, adequate food for all and safe water and sanitation for all is roughly \$40 billion a year. This is less than 4% of the combined wealth of the 225 richest people in the world.

(UNDP, 1998: 30)

The depth of the crisis of world capitalism is shown by the fact that global economic growth in the 1990s was slower than in the 1980s, which in its turn was slower than in the 1970s,

when growth was slower than in the 1960s. Although profits have risen strongly, the world economy has not entered a new expansionist phase with higher levels of accumulation (investment) leading to higher growth of output and more employment. According to the INTERNATIONAL LABOUR ORGANIZATION (ILO), more than 1 billion people in the world were unemployed or under-employed in 1998.

The increased gap between profits and investments is one of the explanations for the financialization of the world economy. This development is exemplified by the growing weight of financial criteria and shareholder value, and the prominent place of stock markets in everyday life and the media. In a break with the international regime since Bretton Woods (see BRETTON WOODS SYSTEM), more and more countries have stopped controlling cross-border financial flows, starting with the United States in 1974. Financial markets are doubtless the most globalized today and amounts that dwarf central bank reserves can be mobilized and sent round the world in a fraction of a second. The increased volatility of financial markets, the explosion of amounts traded daily and the absence of strong global regulatory mechanisms (such as a world central bank) feed the sentiment that the power of CASINO CAPITALISM, in which anonymous traders on financial markets decide people's futures behind their backs, is increasing. The rapid expansion to different parts of the world of the financial crisis that unexpectedly broke out in Asia in mid-1997, adds to the feeling of a severe ideological, social and economic crisis. National and international NGOs are trying to respond to these developments with campaigns for the re-regulation of financial markets, and for taxes on financial transactions and flows (such as, for example, have been proposed by Nobel prize-winner James Tobin).

In essence, the crisis of world capitalism is characterized by the following fact: never before in history was there such a big gap between what is objectively and materially possible, and the real world.

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ROBERT WENT

crisis theory

The concept of crisis is one of the most frequently deployed, yet undertheorized, within international political economy (IPE), remaining one of the most illusive, vague and generally unspecified concepts within the theoreticians' and analysts' armoury. Crisis often implies a radical diagnostic or even prognostic intent on the part of those who deploy it. Yet beyond this, there is little that connects the multiplicity of uses to which the term has been put. Unless preceded by the adjective 'permanent', crises are generally temporary moments or phases; unless preceded by the adjective 'cyclical', generally deviations from the normal (or 'natural') course of events; unless preceded by the adjective 'terminal', generally capable of resolution. Yet this merely serves to highlight the sheer diversity and, indeed, mutual incompatibility of the conditions, properties and processes variously conjured in the notion of crisis. Within the IPE literature, as elsewhere:

crises may be singular, exceptional, recurrent or periodic; momentary, ephemeral, enduring or eternal; linear or cyclical; destructive or creative; underdetermined or overdetermined; inevitable or contingent; pathological or regenerative; organic or inorganic; paralysing or liberating; immanent, latent or manifest. They may be appealed to as

mechanisms, processes, properties or conditions; failures, contradictions, ruptures or catastrophes; endings, beginnings or transitions. And they may refer to subjects, objects, systems or structures; to personality, identity or subjectivity; to modernity, history or Enlightenment; to state, economy or polity; to the environment, the world or the planet; to life, the universe ... and everything.

(Hay, 1996: 422; see also O'Connor, 1987)

Given this observation, the task of summarizing crisis theory within IPE may, at first, appear daunting. However, it is important to emphasize the disparity between the casual and habitual reference to crisis within this literature and the much rarer systematic attempt to outline a consistent and coherent theory of crisis. This makes an account of crisis theory, as distinct from an account of the largely untheorized uses of the term, somewhat less burdensome.

The etymology of the term 'crisis' can be traced to the Greek; it means, literally, to sift or separate and hence to discriminate or decide. Crisis, then, is a moment of decisive intervention. In ancient Greece, crises were seen as 'moments of truth in which the significance of men [*sic*] and events were brought into light' (O'Connor, 1987: 54). The term also came to acquire certain medical connotations, being used by Hippocrates to refer to the turning point in an illness 'in which it is decided whether the organism's self-healing powers are sufficient for recovery' (Habermas, 1975: 1). The sense of crisis as a decisive, fateful and path-shaping moment of political and economic time is well captured by Régis Debray in the following terms: crises

are epoch-making events in the sense that they mark the culmination of one process and the beginning of another. The working-out of a crisis gives rise to a new situation, qualitatively distinct from the situation of the past.

(Debray, 1973: 99)

Such a conception of crisis implies, as it invokes, a particular theory of history in general and of the historical development of the polity, society and the economy in particular. More specifically, it implies a discontinuous or punctuated theory of social and political change – of periods of stasis or incremental change interrupted decisively, even violently, by rapid institutional transformation during moments of crisis (Hay, 1999). Clearly such a conception stands at odds with many, arguably all, mainstream classical and neo-classical approaches to (capitalist) political economy, which are premised on the assumption that capitalism is a self-regulating and self-equilibrating system. Accordingly, it is not surprising that classical and NEO-CLASSICAL ECONOMICS, despite periodic reference to crisis, have developed no general theory of crisis. Thus, as Paul Mattick observes in his review of economic crisis theories,

as regards bourgeois economics ... there is very little to say, as its GENERAL EQUILIBRIUM theory has no room for the dynamics of the disequilibrating process of capital expansion.

(Mattick, 1982: vii)

Nonetheless, as Simon Clarke argues,

even the most apologetic of economists cannot fail to notice that recurrent crises occur, but, developing the traditions of classical political economy, the economists explain such crises as contingent phenomena.

Within such a schema,

crises can only arise as a result of external shocks which temporarily disrupt capitalism or internal disturbances which impede or subvert the processes of market equilibrium.

(Clarke, 1994: 1 2; see also BUSINESS CYCLES)

The principal culprit in such accounts is the overbearing intervention of the state, sanctioning overblown expectations on the part of its citizens and pressure groups alike, and trading concessions which the economy can ill afford

for legitimacy, popularity and ultimately votes (see, for instance, Crozier *et al.*, 1975; also OVERLOAD THEORY).

If the very concept of crisis implies a conception of history that is anathema to neo-classical economists, then the same is certainly not true for Marxists (see MARXIAN ECONOMICS). Indeed, it is with only a small amount of licence that P. Kenway notes in *The New Palgrave* that 'the term "crisis" as used in economics is principally associated with Marx' (Kenway, 1987: 110). For Marx, a crisis is any situation in which the process of the reproduction of capital is interrupted or temporarily impeded. Accordingly, crises may arise at a variety of scales, from the sectoral level to the level of the global economy itself (see CAPITALIST CRISIS; CRISIS, GLOBAL ECONOMIC). Despite the diversity of situations, then, to which the concept of crisis is applied by Marx, he nonetheless remains true to the etymology of the term, viewing crises as temporary moments of decisive intervention. He thus refuses to see long periods of economic decline as evidence of crisis. As he argues in *Theories of Surplus Value*, 'permanent crises do not exist' (Marx, 1969: vol. 2, p. 373).

Though motivated essentially by a concern to establish the conditions under which a terminal crisis of capitalism might arise (which might pave the way to a genuinely post-capitalist society), Marx's principal contribution to the theory of crisis was his analysis of crises as a normal and recurrent feature of capitalist development. His account focuses largely on factors internal (or endogenous) to capitalism itself, appealing only rarely to the untheorized external (or exogenous) factors (such as wars) which characterize classical and neo-classical accounts of crisis. Though, as James O'Connor notes, 'no single or dominant concept or theory of crisis may be found in Marx's work' (O'Connor, 1987: 59), his analysis of the tendency of the rate of profit to fall is perhaps that most consistently developed in his economic writings and that most frequently accorded the status of *the* Marxist theory of crisis. Somewhat paradoxically perhaps, Marx's thesis of the tendency of the rate of profit to

fall is for him a general law of capitalist accumulation. As such, although specific countervailing counter-tendencies to this tendency may be mobilized at particular moments in time at particular stages of capitalist development, the generic tendency for the rate of profit to fall is internal to capitalism itself. It cannot be resolved without a change in the MODE OF PRODUCTION. Marx argues that capitalism is characterized by the incessant search for profit, manifest in the competition between competing capitals. Profit is dependent on the extraction of SURPLUS VALUE in the labour process, surplus which can only be extracted from living labour. Competition establishes an incentive for capitals to achieve lower labour costs, for (if successful in so doing) they can offer their commodities at a lower price, thereby expanding both market share and net profits. The solution for individual capitalists, then, is the mechanization of production, increasing the productivity of labour and reducing unit production costs. Yet herein lies the paradox. For, although it is in the individual interest of any particular capital to lower its production costs as a means of expanding its market share, this can only serve to undermine the collective interest of capital in general. This occurs through the lowering of the net average rate of profit. Since surplus and hence potential profit can only be extracted from living labour (or variable rather than constant capital) and mechanization results in the lowering of the ratio of living labour to constant capital, the logic of competition itself inevitably conjures a secular tendency for the rate of profit to fall (Shaikh, 1978). This tendency, however inevitable, by no means sounds the death-knell for capitalism *per se*. For Marx identifies a series of counter-acting processes, specific to particular phases of capitalist development, which may serve to offset, displace or postpone (though never resolve) the generic tendency of capitalist accumulation to profitability crises. The result is the characteristic patterning of capitalist accumulation in successive 'long waves' or 'LONG CYCLES' of acceleration, deceleration and eventual stagnation.

As well as developing the thesis of the FALLING RATE OF PROFIT (FRP), Marx also returns to an older tradition of economic crisis theory to develop an account of another crisis tendency of capitalism – UNDERCONSUMPTION. This tendency, noted originally by THOMAS MALTHUS and Simonde de Sismondi in the 1850s, derives from the fact that, due to the extraction of surplus, workers are paid less than the value of their labour (as reflected in the total value of the net product). Accordingly, their consumption is never sufficient to buy back the products they produce. This generates an inevitable ‘demand deficit’. Clearly, as it is capitalists to whom this extracted surplus accrues, such a demand deficit could be filled partially by capitalist consumption. However, as Marx and before him Malthus and Sismondi noted, the bulk of capitalist profits (unlike workers’ wages) tends to be saved rather than consumed. This establishes a similarly general tendency for underconsumption and hence OVERPRODUCTION – in more conventional terms, a structural disparity of supply and demand. Like the tendency for the rate of profit to fall, however, problems of underconsumption, though for Marx integral to capitalism itself, could also be alleviated (however temporarily) by investment demand. Thus, as a number of later Marxists have gone on to argue, under conditions conducive to capital investment (the stability engendered by the existence of an unchallenged hegemon and the availability of new technology and new markets), the stagnating tendencies associated with underconsumption could be countered by investment-led expansion (Sweezy, 1946; Baran and Sweezy, 1966). Once again, an acknowledgement of the counter-tendencies to underconsumption serves to suggest the likelihood of long waves of accelerating and decelerating growth, and eventual stagnation.

The empirical acknowledgement of precisely such phases of expanded capital reproduction punctuated periodically by recession and crisis has led to two related developments in the theory of crisis – the *social structures of accumulation perspective* and *regulation theory*

(see REGULATION THEORY). These approaches share many similarities, though while the former is more avowedly post-Marxist, the latter more proudly proclaims its NEO-MARXISM. Both argue that, although capitalism as a mode of production is inherently unstable, the history of capitalism is one of a succession of patterns of economic development and expansion, punctuated only infrequently by structural crises. This presents both sets of theorists with a paradox: how is it that, despite the fundamental contradictions of capitalism, it exhibits apparently stable periods of sustained economic growth? The answer to this question is found either in the social structure of accumulation identified in the former literature or in the complementary pairing of a MODE OF REGULATION (MoR) and a REGIME OF ACCUMULATION (ROA) in the latter. In both cases, a distinct institutional settlement (political, economic and cultural) is identified which serves to stabilize capitalist social relations during an expanded phase of capital accumulation. Eventually, this institutional configuration either dissolves (in the case in the literature on the social structure of accumulation) or proves itself no longer capable of successfully regulating capitalist accumulation (as in the regulationist literature), precipitating a period of crisis out of which a new institutional settlement may arise. Though both of these literatures can trace a clear lineage from Marxist (and indeed Marx’s) conception of crisis, their distinctiveness within this tradition of writing derives from their emphasis on crisis as a mechanism internal to capitalist development and their rejection of any notion of the inevitability of a terminal crisis of capitalism itself. Marxist crisis theory, it would then seem, has moved from an analysis of the conditions conducive to the transcendence of capitalism itself to an internal analysis of the means by which capitalism transforms itself in and through crisis.

See also:

accumulation, logic of; advanced capitalism;

crisis of world capitalism; depressions; fiscal crisis; historical materialism

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COLIN HAY

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critical realism

Critical realism argues for the potential scientific status of the study of social phenomena. It is based on transcendental realism concerning the natural sciences. The natural world consists of three domains: the 'empirical' (experience, impression, perception), the 'actual' (events, states of affairs) and the 'non-actual' or the 'deep' (structures, mechanisms, powers, tendencies). Factors in the deep domain determine/cause events taking place in the actual domain which are observed in the empirical domain. Mere regularities, if any, of events in our experience inform us of nothing about this causality. What is 'real' is in the deep domain. Reality is *structured* (not reducible to the events of experience) and *intransitive* (existing independently of our knowledge of it). It is the deep domain factors that any scientific investigation must identify in the process of scientific explanation. The mode of inference in this explanation is neither induction nor deduction but 'retroduction' (or 'abduction') – that is, a movement, in particular, from manifest phenomena in the actual level to the deep level, through analogy and metaphor.

Critical realism applies this understanding of reality and scientific explanation to the study of social phenomena. From the outset, it recognizes the general absence of event regularities in the social world, arising from the presence of human agents that could always have acted otherwise. Thus critical realism focuses on the questions of the existence of specifically social structures where human agents exert the power of choice and of the interaction between the social structure and human agents. Social reality is *internally relational* in the sense that social objects exist by virtue of their relationship with each other; thus the social sciences must treat their objects of study (such as the economy and the state) as totalities. Regarding

individual agents, therefore, what is significant are the social positions by virtue of which they exercise social practices. Social activity is also *transformational* in the sense that, while individual agents draw on the social structure (usually without acknowledgement) when they make specific actions, the action of all individuals taken together transforms (or reproduces) the social structure (typically unintentionally). The social structure neither exists independently of individual agents, nor is reducible to them.

According to this conception, economics (as a science) can proceed from 'stylized facts'. These are understood as reflecting the mechanisms or tendencies in the deep domain of the economic reality, and in light of them competing hypotheses can be compared for their relative explanatory powers. The transformational conception of social activity implies that any structure is only relatively enduring, thus it is subject to changes with space and time. So economic analysis, too, must be historically and geographically limited, and setting such geohistorical limits must be part of the process of abstraction in economic analysis. Economic policy must not primarily be concerned with manipulating variables in order to control future events (at the 'actual' level), but with transforming structures that govern and facilitate human actions – it is through this that human emancipation can be achieved.

See also:

individualism, methodological; philosophical realism; realism; structural realism

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MAN-SEOP PARK

critical theory

In its broadest sense, critical theory may be characterized as a revisionistic Marxist critique of modern CAPITALISM. While the heritage of critical theory is the Marxian theme of emancipation from capitalist class oppression, the broader goal is the liberation of humanity from all forms of socially or culturally unnecessary domination. Critical theory departs from Marx's emphasis on economic determinism (see DETERMINISM, ECONOMIC) in favour of exploiting the role of ideas and culture in advanced capitalist society as possible new sources of domination that Marx's analysis did not recognize.

Three prominent sources of influence on critical theory are the works of the Hungarian Marxist, Georg Lukács; the writings of the Italian Marxist, ANTONIO GRAMSCI, and the Frankfurt theorists who originated with the Institute of Social Research (founded at the University of Frankfurt in Germany in 1923) and continued following World War II. The principal members of the Frankfurt School were Max Horkheimer, Theodor Adorno, Herbert Marcuse and a few other notables. The most prominent contemporary theorist in the Frankfurt tradition is Jürgen Habermas.

The critical theory of society was formulated both in response to the stagnation of left-wing working class movements and out of disappointment at the rise of fascism and Nazism in Europe during the 1920s and 1930s. In particular, Lukács attacked the economic determinism of Marxism as an inadequate theory of modern capitalism (see MARXISM–LENINISM). He argued that the production of 'false

'Cross of Gold' speech

consciousness' was not merely the mechanical relation of economic exploitation leading to political domination. Rather, people's inability to recognize the contradictions of capitalist society was related to the process of *reification* – that is, cultural practices 'reify' the system, making it appear that it is externally independent of human action or agency, and hence beyond human control.

Gramsci developed the concept of ruling class *HEGEMONY* in order to describe the alienation of workers. Through hegemony, the ideology of the ruling class prevents workers from seeing the reality of their daily lives under capitalism. Ruling class hegemony controls not only capitalist property relations, but also mental production and consciousness through cultural resources such as religion, education and the mass media.

The Frankfurt scholars further developed the critical theory research programme by analysing the role of mass culture and *POSITIVISM* as mechanisms of capitalist domination and *ALIENATION*. Horkheimer suggested that culture and ideology do not simply reflect the economic substructure, but present a semi-autonomous realm which is crucial to capitalism if it is to maintain and strengthen the existing order through commercialization and mass conformity. Adorno attacked jazz and other forms of popular music as modes of standardization that both pacified and distanced the masses from a more active and critical consciousness, an argument along similar lines to Marx's concept of alienation or Lukács' reification.

Marcuse attempted to explain the resilience of capitalism in the epoch of mass culture and consumerism. He argued that modern life itself is alienating, in the sense that people are driven to indulge in hedonistic satisfaction in a totally 'administered' society. For Marcuse, mass society both repressed individuals and eliminated alternative critical thought-forms through the creation of 'one-dimensional man'. Marcuse's critique has been expanded by Habermas, who points out that everyday experience (or what he calls 'the lifeworld') has been 'colonized' by impersonal communicative media, money and

bureaucratic power structures. Modern critical theorists also view the separation of 'value' from 'fact' in the social sciences as a form of positivism that reinforces 'instrumental reason' as being analogous to natural law. Science itself is thus turned into an ideology and becomes a new form of domination.

What distinguishes the Frankfurt tradition from orthodox Marxism is the critique of scientific-technological rationality and the modern culture industry. As 'technocratic consciousness' penetrates all spheres of social life, the legitimation crisis of modern capitalism (according to Habermas) is a crisis of meaning and understanding, resulting from the decline of a 'public sphere' of communication that is free from domination. Nevertheless, Habermas sees emancipation from domination as possible by bringing modern society to an 'ideal speech situation', in which people generate understanding between themselves without any coercion, on the basis of the free exchange and clarification of meanings. Habermas believes societies evolve towards freedom through 'communicative action' – the processes of interpretation, socialization and integration – which will ultimately enable humanity to take conscious control of its own evolution.

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JIELI LI

'Cross of Gold' speech

William Jennings Bryan's address to the 1896 Democratic Convention, to be forever known

as the 'Cross of Gold' speech, was an impassioned plea for a return to BIMETALLISM and away from the GOLD STANDARD of the era. Essentially a call for the inflationary effects of a return to silver coinage, the Free Silver Movement was a reaction by agrarian interests saddled with large debts (and debtors more generally), of Western silver mining interests, and of many labour and commercial interests who favoured the effects of INFLATION and loose money. Bryan cast the issue in the starkest Manichean terms: supporters of maintaining a gold standard were characterized as a small handful of financiers and wealthy capitalists opposed to the broad interests of nearly all 'mankind' in a bimetal system of coinage. Bryan's rousing conclusion demonstrates the power of his oratory and the passion surrounding the issue at the time:

Having behind us the producing masses of this nation and the world, supported by the commercial interests, the laboring interests, and the toilers everywhere, we will answer their demand for a gold standard by saying to them: You shall not press down upon the brow of labor this crown of thorns, you shall not crucify mankind upon a cross of gold.

(Cherny, 1985: 60)

The United States had moved to a gold standard in 1873, when gold was abundant relative to silver. However, the close of the nineteenth century saw a shortage of gold, as most countries moved to a gold standard with no dramatic increase in gold production. Deflation was the result. The call for a return to silver coinage was, in fact, reflective of a desire for inflation. While the forces united around a return to silver were thwarted in their aims, the goal of a growing money supply and its inflationary consequences was met by the increase in global stocks of gold, fuelled by increased extraction and new discoveries.

Bryan's 'Cross of Gold' speech catapulted him to the Democratic nomination, but he narrowly lost the presidential election of 1896 to Republican William McKinley, as he did once again in 1900. A changing macro-

economic environment of growth and stable prices undercut much of Bryan's platform. However, the silver issue and Bryan's contribution to the debate left an indelible mark on American political culture. An entertaining example is L. Frank Baum's *The Wizard of Oz*. The book was written as a thinly veiled allegory of the evils of the gold standard (the yellow brick road). Bryan was portrayed as the cowardly lion, in need of the courage to confront the illusions perpetuated by the eastern industrial establishment.

See also:

monetary policies: quantity theory of money (QTM)

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M. SCOTT SOLOMON

cultural determinism

'Determinism' assumes that people have little individual freedom with regard to biological factors and to physical or social environments. 'Cultural determinism' is a social science approach (comparable to Malinowski's work in anthropology) that teaches that the dominant force in social change is culture, as opposed to approaches which stress the causal primacy of space (geographical determinism), technology (technological determinism), biology (genetic reductionism), relations of production (economic determinism – see DETERMINISM, ECONOMIC), social structure (structural determinism) or power (military determinism). Such approaches are reductionist, because they try to explain social phenomena with a single overarching factor. Cultural determinism, which has affinities with philosophical

cultural industries

idealism, insists on the primacy of religion, art, knowledge, IDEOLOGY, values, law, ethics, education, social status, ethnicity, language, emotions or other cultural dimensions. Most contemporary social scientists reject determinism, either cultural or otherwise, preferring to leave some room (albeit limited) for individual freedom and for the influence of a variety of factors.

See also:

determinism

JEAN-GUY VAILLANCOURT

cultural industries

The 'cultural industries' make up that part of the economy concerned with the production of cultural artefacts: film, television, music, books, dance, theatre, painting and sculpture. Some definitions also include sport and tourism. Early definitions included only 'artists'; more recent definitions are conceptually grounded and include the whole sector from artists through to manufacturing and distribution. Cultural industries are unevenly distributed: they provide a significant positive balance of trade for only a few developed countries, employment is concentrated only in major cities. In such cases, cultural industries play an important role in local economies. Measurement is difficult due to inadequate trade and census classifications. Cultural industries are multifaceted and difficult to evaluate, they provide (directly) economic growth, social mobilization and cultural value.

See also:

sectoral planning; service economy; world city

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ANDY C. PRATT

culture, economic role of

The question of the economic role of culture has major implications for the discipline of political economy. This is because the emphasis it places on values, attitudes and the significance attributed to meaning in the conduct of economic activity leads political economy away from its traditional concern with more readily quantifiable factors, notably the power and resources controlled by the state and the market respectively. To fulfil this task, the concept of economic culture has been developed to denote the social, political and cultural matrix or context within which particular economic processes operate (Berger, 1987: 7). However, because so many components of politics, society and indeed culture do not affect economic performance, an alternative and narrower definition of economic culture has also been advanced, namely those socio-cultural values and attitudes that seem linked to the economic process (Lewis, Fitzgerald and Harvey, 1996: 43).

The question of the economic role of culture, or more specifically national culture, has recently achieved increased salience because of the wide-ranging debate about the extent and significance of the process of GLOBALIZATION of economic activity and the degree to which it has relocated cultural life beyond the realm of the nation-state. The globalization of new media, such as satellite television and the internet, has enabled MULTINATIONAL CORPORATIONS (MNCs) to penetrate the daily lives of millions of people to the degree that the consumer lifestyle choices which they offer their customers have now for many become more important than traditional sources of national culture for the definition of individual and group identity. Indeed, it has been suggested that this penetration of global corporate values into lifestyle choices and

popular attitudes may be leading to a convergence and homogenization of national cultures into a singular global culture (Robins, 1997: 33). Some have become convinced that globalization has created a borderless world in which nation-states have become little more than bit actors (Ohmae, 1995: 12) and national culture increasingly redundant as a source of identity and meaning. Others remain decidedly sceptical about both the novelty of the process of globalization of markets and its significance for the role of nation-states in economic development (for example, Hirst and Thompson, 1996).

Cultural explanations of economic performance, which highlight the particularistic, individual characteristics of a nation, provide an alternative to those economic theories which emphasize the existence of economic forces which universally shape cultural values across different national economies. Cultural explanations contend that national competitiveness is culturally determined by a political, social and cultural context which is particular to a given nation-state. The challenge therefore is to demonstrate a clear connection between culture operating at the macro-level of the nation and economic activity operating at the micro-level of the individual firm. This is an especially difficult task given the scepticism of mainstream economics, which has traditionally sought to explain economic phenomena in terms of more visible and quantifiable data.

For culturalist explanations to be authoritative, they also have to be able to demonstrate that different national economies or companies actually possess specific economic cultures that lead them to behave in a different manner from their competitors. The problem with accomplishing this task is that the very notion of a distinctive economic culture, which is the product of a context that is unique to a particular country or company and which can only be understood in terms of systemic rather than comparative analysis, would appear to eliminate the possibility of any meaningful comparison.

There is the further problem that cultures are dynamic entities which are in a constant

state of flux. The culturalist perspective therefore confronts the problem of how to avoid incorporating a static and reductionist conception of culture that assumes that values and attitudes are intrinsic and constant. If this perspective contends that economic change can and does occur, but within the overall framework of an ongoing national or corporate culture, there is an attendant danger that the notion of an economic culture can become little more than a meaningless catch-all device for explaining economic performance (Lewis, Fitzgerald and Harvey, 1996: 44–7).

The purported poverty of economic discourse, where it fails to acknowledge the importance of culture for explaining differences in economic performance between rival states or firms, has been highlighted by Francis Fukuyama (1995a, 1995b). He has argued that the debate about international competitiveness during the 1990s has been conducted between neo-classical and neo-mercantilist economists, both of which groups have ignored or greatly underestimated the importance of the role of culture for economic performance (see NEO-CLASSICAL ECONOMICS; NEO-MERCANTILISM).

Fukuyama's thesis is that there is a missing 20 per cent of human behaviour about which neo-classical economics can give only a poor account (Fukuyama, 1995a: 13). This is because economic life is fundamentally a social activity that is not carried out by individuals acting in isolation but primarily by organizations, whether public or private, which depend on a high degree of social cooperation for their success. This capacity to work together for common purposes in firms or organizations is what Fukuyama terms 'social capital'. For him, the key to competitiveness in the contemporary global economy lies in the character of civil society and the structure of intermediate associations lying between the individual and the state – whose nature is, in turn, in large part determined and transmitted by the traditions and culture of a particular society.

In addition to a nation's social capital, Fukuyama has identified spontaneous sociability as another key determinant of successful economic performance. Spontaneous sociability is

a subset of social capital which denotes the capacity of private individuals and groups to form new associations and a wide range of intermediate communities which are distinct from both the family and those associations deliberately created by governments. Fukuyama's thesis is that spontaneous sociability is critical to economic life because virtually all economic activity is carried out by groups rather than individuals (Fukuyama, 1995a: 47). Thus, differences in industrial structure (that is, the number, importance and interaction of large firms compared with small and medium-sized firms in a given national economy) can be attributed to the presence or absence of spontaneous sociability in a particular society, which will in turn encourage or discourage the creation of new forms of economic enterprise.

By virtue of this thesis that social capital has a marked impact on the scale and vitality of economic organization and performance, Fukuyama has claimed to be able to account for the 20 per cent of human behaviour that he asserts has been missed by mainstream neo-classical economics. He accomplishes this feat by drawing a distinction between those cultures which exhibit a high degree of trust and those which do not. For Fukuyama, trust is a property of certain societies which arises from their prior sense of moral community – that is, a pre-existing set of shared moral norms and values. It is this sense of trust which helps to reduce the transaction costs of negotiation and enforcement which may act as a barrier to innovation and enterprise in those societies which do not possess this sense of mutual trust (Fukuyama, 1995b: 90).

Differentiating between high trust and low trust societies has enabled Fukuyama to argue that there is no single EAST ASIAN MODEL of economic development. Although East Asian societies do share certain aspects of a common culture, such as a strong work ethic and respect for education, Fukuyama contends that there is a great diversity in the endowment of social capital and trust enjoyed by these societies. Thus, rather than rival European and North American firms and states being challenged by the products of a single Confucian culture,

Asia is characterized by the rivalry of two economic cultures: Japanese and Chinese (Fukuyama, 1995b: 98). Fukuyama depicts Japanese society as one characterized by generalized social trust, whereas he portrays Chinese society as being based on family and kinship and a deficit of trust. He suggests that this deficit has created difficulties for Chinese societies seeking to create large private corporations. Unencumbered by such constraints, Fukuyama speculates that Japan (along with other high trust societies such as the United States and Germany) will be able to adapt more rapidly and flexibly to future technological and organizational innovations.

If Fukuyama's focus is on explaining the role played by different national cultures in economic performance, then Hampden-Turner and Trompenaars (1993) have identified seven cultures of capitalism to help to account for the differences in performance between rival firms in these societies. Their starting point is that the moral values which drive wealth creation themselves originate within the culture of a given society – that is, a deep structure of beliefs is the INVISIBLE HAND that regulates economic activity (Hampden-Turner and Trompenaars, 1993: 4). However, because economics has traditionally been concerned with measuring the quantifiable elements of economic life, such as the allocation of resources, it has tended to neglect the one, almost unquantifiable, component of life which makes all economic activity possible – namely, human relationships. Therefore, to explain differences in economic performance between rival firms and nations, we need to recognize that each firm and nation brings a unique set of values to bear on the process of wealth creation. Indeed, these values characterize both the organization that practises them and the products and services the enterprise creates (*ibid.*: 6).

In order to understand how cultural values influence economic choices, Hampden-Turner and Trompenaars have identified seven fundamental valuing processes without which (they contend) wealth-creating organizations could not exist. Each of these seven valuing processes

displays an internal tension between seemingly opposed values. It is suggested that the organizations which manage to balance these opposing values will be those that will be successful (ibid.: 10). The different ways in which firms manage to balance these seven valuing processes help to explain the seven different cultures of capitalism which Hampden-Turner and Trompenaars are able to identify.

An important counterweight to theories that emphasize the role of culture in explanations of divergent patterns of national and corporate performance has been provided by *The Growth of Nations: Culture, Competitiveness and the Problem of Globalization* (1996), in which Lewis, Fitzgerald and Harvey develop an extensive critique of culturalist explanations of economic performance. They contend that such explanations assume that there are specific, contextually defined aspects of a given country's individual experience which offer the key to understanding national economic success or failure. For example, the culturalist perspective on Japan's economic performance has tended to point to traditional attitudes and Confucian values which have in turn shaped the management style and industrial structure of Japanese companies.

The culturalist perspective implies that any given national culture is a unique systemic structure whose component parts can only be properly understood in systemic, as opposed to comparative, terms (Lewis, Fitzgerald and Harvey, 1996: 25). It is because of the systemic nature of national culture that Lewis, Fitzgerald and Harvey have rejected the work of those, such as Hofstede (1994), who have attempted to create a theoretical framework for comparing diverse cultures based on a selection of preconceived variables. Lewis, Fitzgerald and Harvey have contended that Hofstede's cultural perspective constitutes a serious methodological error, by virtue of its very selectivity and ignorance of the systemic nature of culture. At the same time, they have also criticized the cultural perspective where it involves the investigation of a culture's impact on an empirical basis after the event. Lewis, Fitzgerald

and Harvey claim that this perspective risks reasoning on a *post hoc* basis and making the link between culture and economic performance tautologically (Lewis, Fitzgerald and Harvey, 1996: 25).

They have also developed a powerful critique of cultural perspectives on post-war Japanese economic success and British decline.

Those who argue that there is an economic culture peculiar to Japan which has shaped the industrial structure and management of Japanese companies look to the example of corporate practices such as lifelong employment. The problem with the culturalist explanation of Japanese economic performance is that if Japan does indeed possess a unique economic culture which has shaped the success of its large manufacturing companies, then why is it that this culture has not enabled the agricultural or service sectors of the Japanese economy to perform more successfully? This culturalist explanation also implies that Japanese culture has been a constant during the post-war period, an assumption which overlooks the very major social changes which have occurred in Japan precisely because of its rapid post-war industrial modernization. Moreover, the emphasis on internal corporate practices like lifelong employment neglects the fact that this practice has been confined to a limited number of large companies and has never penetrated the corporate organization of other firms, notably the working conditions of their small and medium-sized subcontractors (Lewis, Fitzgerald and Harvey, 1996: 82-8).

In the case of culturalist perspectives on Britain's relative economic decline, Lewis, Fitzgerald and Harvey have suggested that because the precise nature and extent of Britain's decline is more ambiguous than that of Japan's post-war economic success, Britain is even less suited to the culturalist explanation. However, this has not prevented many authors (for example, Weiner, 1981) from advancing the attractively monocausal thesis that British decline is the product of a longstanding and deeply entrenched anti-industrial culture among the British governing elite, which has been inculcated over the generations by the

values of an elitist educational system and manifested in an absence of entrepreneurial vigour (Lewis, Fitzgerald and Harvey, 1996: 122–9). There are a number of problems with this superficially attractive and simplistic explanation of British decline. It fails to demonstrate how and why the high culture of the governing elite should adversely affect the attitudes and values of entrepreneurs and corporate managers. High culture among governing elites should not be regarded as being synonymous with national culture, for this is to ignore the cultural diversity among the remainder of the population. The culturalist perspective also cannot explain why rival economies such as France, Germany and the United States have been able to sustain a stronger economic performance even though their own elite culture has been characterized by an equally, if not more virulent, anti-industrial literature than that experienced in Britain. Furthermore, empirical research conducted by eminent economic historians has demonstrated that the thesis of a purported loss of entrepreneurial vigour in Britain because of the development of an anti-enterprise culture is simply not borne out by statistical analysis. Thus, it can be concluded that while the culturalist explanation provided for British decline is an intuitively persuasive one, in reality the notion of a deep-seated cultural bias against industry does not stand up to serious empirical scrutiny (ibid.: 129–34). If Britain's entrepreneurs and firms have failed to adapt to an increasingly competitive environment, the answers must be sought in actual political, institutional and economic developments, rather than in nebulous cultural explanations.

The insights offered by Lewis, Fitzgerald and Harvey into the relationship between culture and economic performance would appear to invalidate the cultural perspective on economic development. Their analysis of Japanese and British economic performance has highlighted the inherently selective and ahistorical nature of culturalist arguments, which are ultimately more impressionistic than substantive (ibid.: 79), and the importance of

increasing sensitivity to the specific historical context in which economic development occurs. In short, history – rather than culture – and contextual factors (such as economic incentives) – rather than values and attitudes – have more to offer in explanations of economic performance. Thus, Japanese industrial success should be understood as the result of a unique combination of government, business alliances and individual companies (ibid.: 104), rather a unique economic culture.

Cultural explanations are likely to remain attractive because of the monocausal simplicity of both their analysis of and prescriptions for remedying faltering economic performance. Such explanations will always be open to the criticism that their definition of culture is so infinitely malleable as to be able to account for anything, thereby rendering them tautological and potentially meaningless. Ultimately, the evidence suggests that economic performance is historically contingent and not culturally determined (ibid.: 206–12).

See also:

competitiveness of nations; enterprise culture; political culture

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SIMON LEE

culture, global and consumer

In recent years, the concepts of 'global' and 'consumer culture' have become increasingly

interchangeable, if not (as yet) quite synonymous. Many authors argue that a qualitatively new stage of capitalist accumulation can be identified, emerging in the context of the global economic crisis of the mid-1970s and becoming consolidated sometime in the 1980s. This new phase of capitalist development has been described variously as post-Fordism, 'late' modernity, post-modernity and disorganized capitalism (see DISORGANIZED CAPITALISM; POST-FORDISM; POST-MODERNISM). It is associated, in particular, with the emergence of a global consumer culture.

Consumption, it is argued, has become a pervasive cultural imperative and a central driving force in socioeconomic life. It has become largely separated from the satisfaction of material needs and is now linked much more closely to cultural and symbolic codes and practices – in short, to the satisfaction of psychological desires. In purchasing consumer items, we consume the good itself (and its direct 'use-value' to us) less than its cultural connotations. In so doing, we engage in a process of identity construction, as we literally re-fashion ourselves in the very process of consumption through the items we consume. The contemporary phase of capitalist accumulation is then characterized by reflexive consumption, PRODUCT DIFFERENTIATION, niche marketing, a proliferation of consumer goods and an ever accelerating 'cycling' of symbolic codes of style and fashion. The ADVERTISING and culture industries here play a crucial role in mobilizing a symbolic need and cultural desire for goods for which the consumer has no material need. The result has been a commodification of the aesthetic and an aestheticization of consumption.

Such a view has not gone unchallenged, however. Critics argue that the notion of a global consumer culture is based on an extrapolation from the experience of the privileged few – predominantly white, predominantly middle-class and predominantly resident in the advanced capitalist societies of the northern hemisphere. The reflexive constitution and re-constitution of self-identity, far from a universal feature of contemporary societies, is

cumulative causation

an indulgence only enjoyed by a tiny fraction of the world's population. ENVIRONMENTALISM, in particular, points to the uneven distribution of consumption patterns in the world economy. Environmentalists argue that, although an ecologically unsustainable consumer culture does indeed pervade the northern hemisphere, it stands in stark contrast to the experience of the less developed South. When, as John Bellamy Foster notes, 'energy consumption per person in the advanced capitalist countries is 80 times that in sub-Saharan Africa' (1994: 7), it is difficult to conclude that we inhabit a world united by a *global* consumer culture.

See also:

globalization

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COLIN HAY

cumulative causation

Cumulative causation is one among many types of causality. The best known type is the sequential, or 'Humean', which sees the effect coming after the cause, the cause and the effect operating (each) at a moment of time. C.G. Hempel later refined this conception by arguing that, in order to say that A causes B one has to specify the antecedent conditions under which an instance of A is invariably followed

by an instance of B. Only then can we speak of a causal law. However, given that the market is a vast, continuing web of transactions, economists generally employ another type of causality: namely, reciprocal or mutual causality, in which both cause and effect relate to the same time-period and each of the elements is a cause of the other.

Now, one may think of reciprocal causality in the simple additive way that A affects the causal relation between B and C. Yet the relation between A, B and C may also be asymmetrical, in the sense that A 'fundamentally' conditions the effects of B on C, while B does not shape the effects of A on C to an equal extent. This latter may be defined as a type of structural causality, according to which A is a structure which sets the limits under which B affects C.

Multiple causation is another type, in which many causes are involved in the production of an effect. Multiple causation may be subdivided into two classes: instances in which the various causes continue to produce their own separate effects, and instances in which there is a cumulative effect other than the effects that would be produced separately. This latter instance is a type of *cumulative causation*. In this type, cause and effect become confounded in a sequence of increasing accumulative, or snowballing, complexity. The cumulative effects of such causes are indeterminate.

See also:

chaos theory; complexity theory

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RICARDO DUCHESNE

currency appreciation

A 'currency appreciation' is an increase in the value of the EXCHANGE RATE of one currency in terms of other currencies. For example, when the dollar-pound sterling exchange rate increases we say the pound has appreciated, because the international value of sterling has risen. This, in turn, has an impact on the competitiveness of British goods. The term is most commonly used in reference to a currency with a FLEXIBLE EXCHANGE RATE; upward movements in FIXED EXCHANGE RATES being termed exchange rate 'revaluations'.

See also:

currency depreciation; devaluation, currency; foreign exchange

ALISON M.S. WATSON

currency depreciation

A 'currency depreciation' is a decrease in the value of the EXCHANGE RATE of one currency in terms of other currencies. For example, when the dollar-pound sterling exchange rate decreases, we say the pound has depreciated, because the international value of sterling has reduced. This, in turn, has an impact on the competitiveness of goods from the United Kingdom.

The term is most commonly used with reference to a currency with a FLEXIBLE EXCHANGE RATE; downward movement in fixed exchange rates being termed exchange rate 'devaluation'.

See also:

currency appreciation; foreign exchange

ALISON M.S. WATSON

customs union (CU)

A customs union (CU) is a regional bloc made up of two or more countries which agree to eliminate tariffs and quantitative restrictions on their bilateral trade, and to adopt a common external tariff (CET) with respect to products imported from the rest of the world.

CUs differ from free trade areas (see FREE TRADE AREA (FTA)) in having a common trade policy and in not requiring rules of origin to determine partner-country products. CUs are rather rare trade arrangements. In contrast to the many free trade areas, there exist only a handful of customs unions, the most prominent of which is that of the EUROPEAN COMMUNITY (EC).

An examination of the EC's rules on internal trade and on external trade reveals the complexity of real-life CUs. Even if a CU is assumed to apply only to goods (not services, workers or capital), the EC's experience has shown that trade can be impeded or distorted by a multitude of non-border measures, such as technical standards, health and safety regulations, state aid schemes, public procurement procedures, taxation and para-fiscal charges, and so on. The achievement of completely free trade appears to require a number of additional common measures and common institutions whose role has been virtually ignored in the theoretical literature on CUs. The EC also has an elaborate system for administering its CET and other instruments of trade policy that may be used for contingent protection (for example, anti-dumping duties) or for conducting trade negotiations and concluding trade agreements on behalf of its members.

The theoretical literature on CUs has been preoccupied by the issue of their rationality and welfare effects. As first shown by JACOB VINER, even if CUs increase trade between partner-countries, they do not necessarily improve the welfare of all the member-states. The positive effect of trade creation, resulting from increased trade with the partner-countries, may be outweighed by the negative effect of trade diversion caused by the substitution of

customs union (CU)

partner-country products for cheaper third-country products (see **TRADE CREATION AND TRADE DIVERSION**). In the absence of any other distortion apart from tariffs, for small price-taking countries unilateral and non-preferential trade **LIBERALIZATION** is superior to a CU. The early literature concluded that CUs were a rational arrangement only for those countries which could enhance their market power. By entering into a CU, they could benefit from favourable changes in their **TERMS OF TRADE** with the rest of the world.

Subsequent developments in the literature examined possible ways for rationalizing the formation of CUs by introducing other kinds of market imperfections. More recent work has

explored the effects of CUs on the location of economic activity, the linkages between integration and agglomeration effects (that is, the benefits of locating in a particular area) and the impact of CU formation on the multilateral trade system.

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PHEDON NICOLAIDES

D

debt crisis

The rapid accumulation of external debt by developing countries in the 1970s and 1980s caused a crisis in two senses. First, there was the danger that the default of some countries with very large debts could have brought about the collapse of the Western banking system. Second, the inability of many less-developed countries to service their debt damaged their development prospects and continues to do so.

The origins of the debt crisis can be traced to the effects on the world economy of the rise in the international price of oil in 1973–4 caused by the CARTELIZATION of the oil industry by the ORGANIZATION OF PETROLEUM EXPORTING COUNTRIES (OPEC). Most developing countries are net importers of oil. Middle-income developing countries were able to finance their resulting balance-of-payments deficits in the 1970s by borrowing oil-surplus funds which OPEC countries had channelled into the eurocurrency and other international capital markets (see EUROCURRENCY MARKET). These funds were available because some OPEC members, especially those in the Middle East, were unable fully to absorb their additional oil export revenues by increasing their imports.

Borrowing was stimulated by the fact that expansionary monetary policies in the major industrial countries in the mid- and late-1970s caused world interest rates to be low in nominal terms, and an acceleration of world inflation made real interest rates negative. Faced with a decline in their TERMS OF TRADE and a consequent fall in real income, Western governments resorted to Keynesian macro-economic expansion (see KEYNESIAN ECONOM-

ics), with little regard to the inflationary consequences. The credit expansion associated with these policies was another factor increasing the flow of funds into the capital markets.

When OPEC again raised the oil price in 1979, responding to world inflationary pressure, there was a further and substantial build-up of debt. The bulk of international lending still went to a small number of countries: by 1983 roughly half of it was owed by Argentina, Brazil, Mexico and also South Korea. Poorer developing countries, particularly those in sub-Saharan Africa, were not able to borrow large sums from private capital markets. Instead they relied mainly on concessionary finance from industrial countries and from the international agencies.

Changing conditions in the world economy in the early 1980s raised problems of servicing the debt. The experience of inflation in the United States and Europe had led to major changes in macro-economic policy. Governments were elected in the US and several other Western countries who were committed to giving the reduction of inflation a higher priority than the maintenance of full employment. The resulting adoption of monetarist policies of credit-restriction led to a rise in nominal interest rates, and the policies' success in reducing inflation made real interest rates rise sharply. President Reagan's cutting of taxes in the mistaken belief that this would *raise* tax revenue by stimulating a supply-side response, led to the restrictive monetary policy being combined with expansionary fiscal policy, putting additional upward pressure on interest rates (see SUPPLY-SIDE ECONOMICS).

Three additional factors worsened the debt problem: macro-economic contraction in the industrial countries reduced demand and lowered

developing countries' export growth; the macro policies of the US appreciated the dollar until 1985, raising the value of dollar-denominated debt and debt-service in the debtors' own currencies, and, as interest rates rose, commercial banks began to doubt the ability of debtors to service their debts. In early 1982 they began to curtail their lending to Latin America.

Mexico's announcement in August 1982 that it could no longer pay debt-service is customarily regarded as marking the start of the debt crisis. Argentina defaulted too, earlier that year, and Brazil defaulted later in 1982. Venezuela, Peru, Chile, the Philippines and Poland also all defaulted in the early 1980s. The size of loans to the Third World, particularly Latin America, meant a number of American and other banks had loans outstanding which totalled more than the bank's total capital. The possibility that default by one or more large debtors could cause the demise of a major bank raised the possibility of a banking collapse through a chain reaction into the rest of the financial system.

The immediate crisis caused by Mexico's default was dealt with in three stages. First, emergency measures were taken to extend debt due to mature over the coming two years to longer periods. In the debt restructuring for Mexico, Brazil and Argentina in 1982 and 1983, new money was also made available so they could meet their debt-service obligations in the short term. The second stage saw involvement by the INTERNATIONAL MONETARY FUND (IMF) with the aim of instituting policy reforms in debtor countries. The IMF would oversee policy changes as part of its lending CONDITIONALITY and, in the meanwhile, the banks started to restructure debt, including the use of DEBT-EQUITY SWAPS for Mexico.

The third stage was marked by the BAKER PLAN in 1985, which followed several years of severe economic contraction in debtor countries as they brought their balance of payments under control. By 1986, the IMF was collecting more in debt-service payments from heavily indebted countries than it was giving in new loans to them. Compliance with the often

severe deflationary conditions imposed by the IMF on its loans had become a condition for debtors to receive further financing from commercial, or other official, sources. In this sense, the IMF's role was more important in facilitating the revival of commercial lending than as a provider of finance itself. Commercial banks agreed to make new lending available on the understanding that structural adjustment would be undertaken by the debtors to improve their long-term economic performance. Over the next three years, some \$13 billion of new lending was made by the banks. The WORLD BANK was brought in to work alongside the IMF in overseeing these policy changes; in the 1980s, the World Bank had moved increasingly to policy-based lending conditions instead of conditions based on the performance of particular projects.

Subsequent action on debt, combined with further pressure for economic policy reform, was undertaken under the BRADY PLAN of 1989, with IMF and World Bank involvement. The emphasis switched from debt rescheduling alone to rescheduling together with debt reduction; \$10 billion of new finance was to come from each of the IMF, the World Bank and the Japanese government. A major debt-restructuring agreement was made with Mexico in 1989 and, subsequently, with other large debtors (including Brazil, Argentina and the Philippines).

With these measures, and as commercial banks increasingly have written off bad debts owed by the Third World, the threat to the banking system has largely passed, although Mexico did again come close to default in 1994 after balance-of-payments problems. There has developed a secondary market in debt, with discounts on the face value of the debt varying greatly according to the credit-worthiness of the debtor. Many new instruments have been developed to handle restructuring, including the exchange of loans for bonds.

Poorer developing countries (especially in sub-Saharan Africa) that had accumulated debt since 1973-4, posed little threat to the international banking system. Their debts were small compared to the large Latin American

debtor nations and the bulk of their debt was owed to multilateral agencies, not to commercial banks. The debt problems for poorer developing countries consisted of having to devote larger and larger proportions of their export earnings to paying the principal and interest on the debt. Sub-Saharan African countries had remained heavily dependent on primary commodities for foreign exchange with which to service their debt and were badly affected by the collapse in commodity prices in the mid-1980s. From 1984 to 1990, there was negative net lending to sub-Saharan Africa by the IMF, as loan repayments exceeded new disbursements. In the 1990s, some African countries were still paying high proportions of their export earnings in debt-services: Mozambique in 1995, for example, was paying 35 per cent, Sierra Leone 60 per cent and Guinea-Bissau 67 per cent.

FOR SEVERELY INDEBTED LOW-INCOME COUNTRIES (SILICS), debt-service is a serious handicap to their development prospects, as recognized in the 1996 HIGHLY INDEBTED POOR COUNTRIES (HIPC) INITIATIVE. When foreign-exchange earnings have to be allocated to debt-service, imports which are already low have to be reduced further. Production suffers too, since such domestic industry as exists in the country is often highly dependent on imports of intermediate products and raw materials. The public expenditure cuts usually required by the IMF and the World Bank damage living standards. In contrast to much of Latin America and Asia, where growth has resumed (at least, in the case of Asia, prior to the 1997–8 Asian crisis), low-income debtors still faced poor development prospects, including low prices for their primary commodities. Their problems need more fundamental solutions than debt rescheduling. Individual creditor governments increasingly have written off old loans and have started to provide aid only (or mainly) in the form of grants. Commercial loans have declined in importance for severely indebted countries and concessionary aid was making up some three-quarters of their capital inflows in the early 1990s. Foreign investment inflows are negligible, unlike the case of

middle-income debtors in Latin America and Asia.

The experience of low-income developing countries also raises the more general issue of whether the debt crisis for individual countries has been the result of internal mismanagement as much as adverse changes in the external environment. Certain countries which were heavily indebted have been able, by economic growth, to manage their debt-service. Among middle-income countries, South Korea in 1980 had a higher ratio of external debt to national income than did Mexico, Brazil and Argentina, yet by 1994 had a ratio of debt-service to exports of only 7 per cent. Among low-income countries, China (which was almost at Latin American levels of debt in the early 1990s, with \$100 billion of external debt) has been able to cope by rapidly expanding its export earnings. However, the ASIAN CRISIS has shown that certain Asian countries (such as Korea and Indonesia) have been unable to cope with high levels of very short-term commercial debt.

Economic policy changes in debtor countries have been influenced by the policy conditions attached to World Bank and IMF lending. The IMF has moved away from the largely restrictive conditions imposed in the early 1980s, recognizing that debt problems are associated with wider difficulties than the balance of payments alone. The shift towards growth-oriented policies has been accompanied by greater involvement by the World Bank. Some developing countries feel that the combination of the two agencies is too strong an influence on domestic policy. The two agencies' stress on economic liberalization as the solution to development remains highly controversial, although in the late 1990s there has been some evidence that the World Bank is moving away from this so-called WASHINGTON CONSENSUS towards a less dogmatically market-oriented approach.

See also:

conditionality; debt-service ratio; soft loan

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useful on the measures taken to resolve the debt crisis.

JOHN THOBURN

debt default

Although Walter Wriston, a former president of Citicorp, famously remarked during the mid-1970s that 'countries cannot go bankrupt', at least one-third of all nation-states fell into effective default during the 1820s, 1870s, 1930s and 1980s 90s economic crises. Corporations and consumers too have regularly suffered excessive financial liabilities. The power of creditors is the key determinant of whether debtors can default. Nation-states of earlier periods were fortunate because decentralized, individual foreign-bond holders were in a weak negotiating position, compared to today's well-coordinated, information-rich creditor groups (for example, the PARIS CLUB).

As a global phenomenon, the periodic rise of debt can be traced initially to growing corporate demand during economic recovery. As technological innovations escalate and spread (requiring financing beyond simple revenue streams), peripheral areas become more tightly integrated into the world economy, supported by international financial networks which often 'push' credit to sovereign borrowers. But as innovation-led growth subsides and as consumer markets in core countries become saturated, profit and wage rates decline, with subsequent pressure on the tax base. Debt rises as corporations, consumers and states augment inadequate revenue inflows with credit. Although in the process of core-country investment saturation, waves of financial capital flow into peripheral areas, PORTFOLIO INVESTMENTS are soon met by low and uncertain real returns (especially when currencies fall in value), political tensions (for example, policy conflicts with powerful, interventionist financiers, sometimes in the form of mass popular 'IMF riots') and economic

constraints to repayment (for example, declining TERMS OF TRADE, foreign-exchange shortages and high real INTEREST RATES in relation to both the historical record and the return on fixed investment).

The main (temporary) sovereign defaults in recent times were by South Africa in 1985, Brazil in 1987, Russia in 1998 and 2000, and Ecuador in 1999. But most low-income countries effectively defaulted on commercial bank loans during the 1980s, which led to increased lending by the Bretton Woods Institutions (largely to pay interest on old loans) (see BRETTON WOODS SYSTEM). Northern bank vulnerability was hence reduced and subsequent debt rescheduling through the BAKER PLAN (1985) and BRADY PLAN (1988) was accompanied by a reduction of North–South financial flows (which went from positive to negative in net terms in 1987). With Third World living standards collapsing, minor multi-lateral debt relief was offered to select states through the HIGHLY INDEBTED POOR COUNTRIES (HIPC) INITIATIVE (1996). But the initiative was widely acknowledged (even by Washington) as ‘too little, too late’, and under political pressure the G-8 countries agreed to speed up the write-downs of unrepayable debt (1999). However, relief was conditioned on compliance with controversial structural adjustment directives.

Default has, however, occasionally been promoted as a resistance strategy. Moves by Fidel Castro and Julius Nyerere to organize a debtors’ cartel (1983) were foiled, largely because of symbiotic relations between South political elites and the global financial system. Subsequently, the church-based activist group Jubilee 2000 – with strong South chapters in politicized sites like the Philippines, South Africa and Nicaragua – was the apex of 1980s–90s global civil society debt-cancellation advocacy (1997–2000). At a national level, Mexico’s *El Barzon* (‘yoke’) movement organized one million debtors – mainly the middle-class and farmers – to default on bank loans, so as to force negotiations for better terms, when domestic interest rates soared (1995). And, at a local level, the South African township ‘bond

boycott’ tactic represented a widespread consumer non-payment protest against banks whose mortgage loans financed shoddy housing under conditions of political repression (early 1990s).

Even under recent conditions of sovereign debt-management, the need to avoid default was expressed vividly by INTERNATIONAL MONETARY FUND (IMF) managing director Michel Camdessus in an appeal to bankers for ‘creditor councils’ which discipline those ‘individual “dissident” creditors’ who catalyse ‘panic-stricken asset-destructive episodes’ through over-zealous foreclosure actions (Camdessus, 1999). The idea of establishing an international bankruptcy court has also been mooted to this end.

See also:

debt crisis; debt management (DM); debt problem

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PATRICK BOND

debt management (DM)

Debt management (DM) is a set of principles pertaining to the management of either external or internal debt, or both. DM is intermingled with either net creation of new debt or net retirement of old debt. DM has several objectives and some of the objectives may at times be mutually conflicting. The present discussion concentrates on external DM as it is more relevant for international political economy (IPE).

Major objectives of DM

DM has many objectives. However, here we will mention only some of the major objectives. First, one of the most important objectives of DM is to reduce the management problems involved in, and the funding of, as much debt as is possible. The second objective is to minimize the interest-cost on the debt. The third is to secure the maximum possible coordination of fiscal and monetary policies. Fourth, the purpose of DM is to manage the debt without affecting the tempo of general economic progress of the country.

DM and Third World countries

For many poor countries, the burden of external debt has been back-breaking and interest payment every year is a serious national problem. In order to minimize the problem, the BAKER PLAN in 1985 suggested increased liquidity to the debtor countries through fresh lending by commercial creditors, debt rescheduling by the London and Paris Clubs and general balance-of-payments support from the international financial institutions. The plan promised \$20 billion of new bank finance and an additional \$9 billion in official loans for the heavily indebted countries.

While the Baker Plan emphasized additional liquidity, the BRADY PLAN in 1989 emphasized interest-rate reduction, market-based debt swapping, conversion of bank debt to government bonds and debt buy-back provisions. To some extent, the Brady Plan was helpful for the debt-ridden Third World countries. Some of these countries resorted to emergency borrowing from the international financial institutions (IFIs) and other friendly countries at lower interest rates for a longer period of time to pay off the earlier debts. Borrowing from IFIs may be more desirable in the sense that it will have less political strings attached to it.

The inducement to increase the inflow of private foreign capital can be an important plank of DM. This has proved to be very beneficial for the South-East Asian economies, but requires several prerequisites to be fulfilled:

for example, a high degree of politico-economic stability, a supply of cheap labour, absence of strong trade unions, high interest rates and so on. High interest rates may attract foreign capital and savings, and may also help indirectly by propping up the exchange rate of a country. In the newly industrializing economies (NIEs), DM did not become so difficult mainly because of high rate of economic growth fostered by a large amount of FOREIGN DIRECT INVESTMENT (FDI). But with the outflow of hot money and short-term capital since July 1997, most of these economies fell back once again into the grip of the DEBT TRAP.

As a matter of fact, high interest rates – which may be favourable for the management of external debt through large capital inflow – may prove to be a serious problem for the management of internal debt. It is, therefore, necessary to work out a suitable trade-off for the management of internal and external debts. While there is possibility of monetary policy dilemma during the period of DM, the operation of fiscal policy remains more or less uniform, being restrictive in nature for both internal and external debt.

The operation of structural adjustment mechanisms, in the form of fiscal monetary restrictions, liberalized trade and exchange-rate policies, privatization and so on, has caused dislocation to many of the developing countries. The IMF bail-out of some of the crisis-ridden South-East Asian countries (for example, Indonesia and South Korea) during 1997–8 did more harm than good. It is now realized that the package offered by the IMF was not helpful either for debt management or for the management of financial crisis. In fact, the world financial institutions are themselves in need of urgent reorganization and reform.

External debt is to a great extent due to the loan-pushing strategy of the rich foreign lenders (Basu, 1991). Therefore, they should partly bear the brunt of DM responsibilities. The very poor countries can legitimately demand the repudiation of their external debt, as was done by the United States after the American Civil War and the USSR after the October Revolution. Such a demand could be

pushed through the UNITED NATIONS (UN), which can recommend the necessary writing off in favour of poor countries. Some of the richer developing countries, however, seek to internationalize the debt by selling various types of attractive bonds and securities (such as lottery bonds and constant purchasing power bonds) to foreigners in order to lengthen the maturity period of public debts, a part of which may be passed on to future generations which will enjoy the fruits of economic development. The internalized debt can be dealt with effectively by a proper policy of economic management. The generation of surplus through the productive use of resources and the reduction in conspicuous consumption may go a long way towards helping the management of public debt. Patriotic appeals and moral suasions have also been proved useful in many countries for the mobilization of additional resources for DM.

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B.N. GHOSH

debt problem

Debt crises have been a recurrent feature of the international political economy since the emergence of significant cross-border lending in the early nineteenth century. From the perspective of creditors, the central risk in cross-border lending arises from the difficulties in enforcing loan contracts, particularly with sovereign borrowers. Because of the lack of established international bankruptcy procedures, creditor

governments have repeatedly been drawn into international debt negotiations.

From the perspective of debtors, the main policy difficulties centre on the costs of repayment, particularly in the face of adverse and unexpected shocks. Governments facing large foreign debts and foreign exchange constraints are caught between the reputational costs of default and the difficult politics of extracting resources to pay foreign creditors.

A variety of mechanisms, including 'gunboat diplomacy', have been used at different times to manage the conflicting interests of creditors and debtors during crises. In the post-war period, the INTERNATIONAL MONETARY FUND (IMF) has played an increasingly central role in this process. However, bilateral negotiations between creditors and debtors, rescheduling and (in most cases) some forgiveness have been central features of the resolution of all debt crises.

The history of international lending shows a cyclical pattern of lending booms punctuated by repayment problems. Beginning in the 1820s, Russia, newly independent Latin American countries, US states and peripheral European countries began borrowing from the major British and French banking houses. The period from 1860 to 1914 marked the heyday of international lending, led by London as the pre-eminent financial centre. Financial interdependence before World War I reached levels not attained again until the 1990s. Lending during this period concentrated on the financing of railways and other infrastructure, which served to integrate new regions into international trade. Following the end of World War I, New York became a major financial centre, lending not only in the Western Hemisphere, but to Germany and other Central European countries as well.

All of these lending booms ended in defaults, and in some cases outright repudiation. Debt crises were typically triggered by adverse movements in the TERMS OF TRADE, international economic downturns or, as in Russia, by political upheavals. The means for managing these crises varied. In Mexico, Egypt and several small Caribbean countries, major powers intervened militarily and guaranteed

debt problem

repayment by seizing control of customs and other direct means. Strong diplomatic pressure was typically brought to bear by creditor governments. In a handful of prominent cases, such as the Barings crisis of 1890 involving British lending to Argentina, the Bank of England intervened with a rescue package.

However, the standard mechanism for resolving defaults was negotiations, sometimes extremely prolonged, between bondholders' committees and debtor governments. Despite the best efforts of the bondholders, these negotiations frequently resulted in some write-down of the debt.

International financial flows, and the means for managing debt crises, changed in important ways in the post-war period. Capital flows to both the developed and developing countries initially took place either through newly created multilateral development institutions (particularly the WORLD BANK) or through bilateral development assistance, the most significant example of which was MARSHALL PLAN assistance to Europe. Beginning in the 1960s, however, 'offshore' markets for dollar-denominated assets emerged in Europe. When the first oil crisis hit in 1973, these EURO-MARKETS and the major MONEY-CENTRE BANKS that made them became the locus of international financial recycling. Oil-rich Middle Eastern governments and multinationals operating abroad deposited funds with Japanese, European and US banks. These banks organized large-scale syndicated lending to developing country governments seeking to maintain growth in the face of rising oil prices. Socialist countries, including Poland and Hungary, also became significant debtors.

Although several middle-income countries, most notably Indonesia and Turkey, experienced debt problems prior to 1980, the second oil shock, world recession and high interest rates of the early 1980s triggered a new wave of debt crises. The largest debtors were concentrated in Latin America – particularly Mexico, Brazil and Argentina – but Poland, the Philippines and a number of African countries also experienced crises.

In contrast to earlier periods, international

institutions played a central role in crisis management. Countries experiencing BALANCE OF PAYMENTS problems and inability to repay would take short-term loans from the IMF, which would oversee STRUCTURAL ADJUSTMENT PROGRAMMES (SAPs) designed to restore countries to creditworthiness.

The nature of these programmes was highly controversial, because of their conditions (see CONDITIONALITY) and the implicit assumption that debtors (rather than creditors) should bear the full cost of adjustment. The drying up of foreign lending implied that governments had to reverse current account deficits through a combination of devaluation and a tightening of fiscal and monetary policy (see MONETARY POLICIES). Over the 1980s, a variety of additional structural adjustment measures were added to the list of expected policy reforms. IMF programmes appeared to enforce private loan contracts and were typically based on the assumption of full repayment.

In fact, the IMF was just one player in a more complex drama that involved creditor countries and the banks as central actors. Concerned about the solvency of their banking institutions, creditor countries typically intervened to facilitate reschedulings on a case-by-case basis, including through the provision of supplementary funds. For the smaller borrowers (particularly in Africa) whose debt was overwhelmingly in the form of public lending, governments coordinated rescheduling negotiations through the so-called 'PARIS CLUB'. By the 1990s, the advanced industrial states were engaging in large-scale debt forgiveness for the largest borrowers.

The large money-centre banks were at the core of the rescheduling efforts. Through inter-bank committees (the so-called 'LONDON CLUB'), banks would agree to provide some new funding for the largest borrowers in return for multi-year rescheduling plans. By the late 1980s, however, banks began to write down losses, debt began to trade in secondary markets at a discount and, in 1989, the US government proposed the BRADY PLAN (an idea initially advanced by Japan and France), which allowed for outright debt relief. By the

1990s, the major Latin American debtors had regained access to the market and capital began to flow through a variety of new channels, including into STOCK MARKETS.

The mid-1990s saw another round of debt crises, beginning with Mexico in 1994 5. A new wave of debt and financial crises began in the summer of 1997 in Asia, spreading quickly from Thailand to Malaysia, Indonesia and South Korea. Although the exact causes of the crisis varied somewhat between cases, all could be traced to financial LIBERALIZATION, weak domestic REGULATION of foreign borrowing, FIXED EXCHANGE RATES and accumulation of short-term debt. In contrast to the Latin American debt crises of the 1980s, the Asian financial crisis could be traced largely to lending to private commercial banks (and in Indonesia's case to corporations) rather than to governments (see ASIAN CRISIS). The result was that debt crises quickly metastasized into broader domestic financial crises. IMF conditionality expanded accordingly to include financial sector reform. In August 1998, the Asian crisis became a global one when Russia effectively defaulted on domestic government debt, much of which was held by foreign institutional investors.

The Asian financial crisis once again generated heated debate about the role of the IMF and whether its policy response to the crisis had been appropriate. The crises of the 1990s also triggered wide-ranging international negotiations on reform of the 'international financial architecture', including increased financial transparency with respect to the extent of foreign indebtedness, improving regulation in both lending and borrowing countries, and the question of how to resolve defaults on cross-border loans. Among the proposals were suggestions for institutionalizing the private rescheduling process, so that losses could be recognized more quickly. Despite calls for radical reform of the system, from the abolition of the IMF to the creation of altogether new institutions, the post-crisis reforms appear relatively modest, focused primarily on improving the regulatory regimes in debtor countries.

See also:

debt crisis: new international financial architecture

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STEPHAN HAGGARD

debt ratios

One of the tools used in the determination of a CREDIT RATING and other financial analyses, 'debt ratios' are a way of determining the debt-bearing capacity of an individual, corporation or sovereign government. Ratios relate a revenue stream to a set of financial liabilities: for example, a country's external debt-service costs for one year over one year's export earnings. Widely used assumptions about acceptable debt ratios are a significant factor in credit rankings.

See also:

national debt

TIMOTHY J. SINCLAIR

debt trap

Cheryl Payer was one of the first observers to write extensively on the 'debt trap' phenomenon in the context of developing countries. To her, 'debt trap' described a situation in the early 1970s in which the developing countries' irresponsible accumulation of short-term suppliers' credit had reached the point where it threatened 'to bring the entire aid/debt/dependency system crashing down from its own weight' (Payer, 1974). Here, the debt trap reflected the double bind that these countries found themselves in *vis-à-vis* the WORLD BANK and INTERNATIONAL MONETARY FUND (IMF). If the countries sought help from these institutions in softer than commercial terms, they had to accept outside scrutiny, give up projects they might sincerely believe to be essential to their national welfare and accept conditions which doomed their efforts at industrial, diversified development. On the other hand, if they accepted suppliers' credits on commercial terms, in order to go ahead with their projects, they were caught anyway when their payments came due before they were able to meet them.

Using a Marxian framework, Payer likened the situation to one of peonage, where indivi-

dual workers were unable to use their nominal freedom to leave the service of their employer because the latter supplied them with credit. Payer contended that nominally independent countries found that their debts and their constant inability to finance current needs out of imports kept them 'trapped' – that is, tied to their creditors. In this situation, the IMF

orders them in effect to continue laboring on the plantation, while it refuses to finance their efforts to set up in business for themselves. It is debt slavery on an international scale. If they remain in the system, the debtor countries are doomed to perpetual underdevelopment, or rather to development of their exports at the service of multinational enterprises at the expense of development for the needs of their own citizens.

(Payer, 1974: 48)

Non-Marxian writers usually focus on the more technical aspects of excessive debt and associated 'debt traps'. In this context, the trap that results from excessive levels of public-sector debt manifests itself in at least four ways:

- 1 *Crowding out*: Heavy government borrowing may push up interest rates, displacing private investment. Over time, falling private investment results in the country being trapped by economic stagnation.
- 2 *Inflation*: Governments may finance their deficits by printing money and so allow inflation to erode the real value of their debt. Fears that countries may inflate their way out of trouble may lead investors to demand higher interest rates, trapping the country with excessive debt burdens.
- 3 *Fiscal flexibility*: Excessive debt can constrain governments' ability to use fiscal policy to support demand in a recession, trapping the country in a state of prolonged recession.
- 4 *Debt trap proper*: Beyond a certain level, indebtedness can cause a vicious circle: rising debt increases interest payments, which in turn leads to extra borrowing, and so on. If higher debt also pushes up interest rates, the

circle becomes even more vicious. The arithmetic is simple: if real interest rates are higher than a country's growth rate, debt will rise indefinitely unless the government is running a big enough surplus on its primary budget (that is, excluding interest payments). Put differently, a debt trap occurs if the effective real interest rate on the national debt exceeds economic growth. In this case, interest burden as a share of GDP will compound even if there is no budget deficit. And if there is a budget deficit that, as a share of GDP, exceeds economic growth, that will tend to exacerbate the interest burden further.

While several industrial countries (such as Italy in the early 1990s) have shown signs of slipping into a debt trap, the phenomenon is still largely endemic to the developing world. Here, unsustainable debt has created serious foreign-exchange constraints. In sub-Saharan Africa in the late 1990s, debt-servicing absorbed between one-quarter and one-third of foreign-exchange earnings, diverting resources from investment. Although DEBT-SERVICE RATIOS have started to fall, this is largely because of a widening gap between scheduled payments, which amount to over 50 per cent of export earnings for the so-called 'highly indebted poor countries' (see HIGHLY INDEBTED POOR COUNTRIES (HIPC) INITIATIVE), and actual payments. As a result, arrears have been accumulating rapidly, with countries such as Mozambique and Ethiopia meeting less than one-third of their scheduled payments in the 1990s. Payments on arrears now account for over one-third of the debt-service obligations of the most indebted low-income countries. But the accumulation of arrears has also contributed to another dimension of the debt trap: namely, an unsustainable debt stock. This has served to deter investment, domestic and foreign, and to undermine economic stability.

Less visible than the foreign-exchange dimensions of unsustainable debt are the domestic-budget dimensions. In many highly indebted developing countries, the burden of debt repayments has contributed to the FISCAL

CRISIS of the state – the growing inability of governments to cover their spending out of taxes. This is especially apparent in the social sector, where budgets have been drastically cut in the interests of financing debt repayments. High levels of dependence on aid, which accounts for over half of social-sector spending in many HIPC countries, is the corollary of this fiscal crisis, exposing debtor governments and vulnerable communities to the threats posed by uncertain and diminishing aid transfers.

See also:

debt crisis; less-developed country (LDC) debt management

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ROBERT LOONEY

debt-equity swaps

Debt-equity swaps are a method of reducing the burden of foreign debt and debt-service for an indebted nation. They involve debtors buying back debt, at a discount on its face value, in exchange for the debtor's domestic currency. The seller of the debt can then use the local currency to invest in equities in the debtor country.

Debt-equity swaps are one method by which debtor nations have been able to share in the large discounts in the secondary market for debt which emerged in the mid-1980s. These discounts reflected the market's belief that commercial debt never would be repaid fully.

The first such swap occurred as part of Mexico's 1984 restructuring of its debt to the commercial banks. They have since been used extensively under BRADY PLAN debt-reduction agreements. Debt-equity swaps have been used as part of the process of PRIVATIZATION (as in the cases of Argentina and Chile), where the

debt-service ratio

government already owns the equity to be purchased.

See also:

Baker Plan; debt crisis; International Monetary Fund (IMF); World Bank

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JOHN THOBURN

debt-service ratio

A debtor country's annual payment of interest on its debt and annual repayments of the principal, expressed as a percentage of its annual export earnings, is known as the debt-service ratio. The ratio is one measure of a country's debt burden. Other possible measures of debt burden are the ratio of total outstanding debt to national income or to exports.

In 1995, three countries were paying over 50 per cent of their export earnings in debt-service – Sierra Leone, Guinea-Bissau, Zambia – while Mozambique, Haiti, Nicaragua, Pakistan, Algeria, Brazil and Hungary had ratios of over 35 per cent. Such high debt ratios can seriously inhibit a country's ability to finance imports and the lack of foreign exchange for imported intermediate products and capital goods can result in reduced utilization of domestic industrial capacity and lower domestic investment.

Most of the major Latin American debtor nations, whose difficulties brought about the DEBT CRISIS in the early 1980s, have seen large falls in their debt-service ratios as a result of debt rescheduling and debt reduction.

See also:

highly indebted poor countries (HIPC) initiative; severely indebted low-income countries (SILICs)

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JOHN THOBURN

decolonization

Decolonization is the process of transformation by which formal political control by one state over another is ended, recognizing the people of that state's right to form their own government. This new state is then free to take its place as a full member of the international community. As a result of the significant amount of decolonization that has taken place since World War II, there are now more than three times the number of nations in the world than existed in the immediate post-war period.

To understand the process of decolonization, it is useful to briefly outline something of the manner in which states were colonized in the first place. Many of the colonizing states were European and took formal control over other states in a process that began in the fifteenth century with the development of ships and military technology of a standard that ensured that European countries could gain control of the coastal cities and resupply outposts that were a part of their major trade routes. Gradually this control extended further inland, first in Latin and North America, and later throughout Asia and Africa. Although this resulted in a certain level of economic development in the colonies, nevertheless they were more often organized in such a way as to meet the needs of the colonizers rather than to benefit the indigenous population of the colonized state.

The process of decolonization really began with the British colonists in the United States declaring independence in 1776. This was

followed by most of the Latin American colonies gaining their independence a few decades later and the gradual achievement of independence by former colonies of the European imperial powers after World War I. Nevertheless, it is the great wave of decolonization involving Asian and African states in the wake of World War II that has come to typify the term. For example, between 1956 and 1960 forty-three states achieved independence, while fifty-one states achieved independence between 1961 and 1980. Indeed, by this time almost no European colonies remained. Moreover, unlike the North and Latin American cases, it was the native populations in Asia and Africa who won their independence. This drive towards decolonization in the post-1945 period was a response to the economic crisis faced by a colonial system that was struggling to cope with the financial legacy of World War II. Large colonial powers, such as France and Great Britain, could no longer cope with the considerable (and most of the time unacceptable) financial costs of maintaining such a position. Moreover, colonialism was increasingly discredited among the people of the colonizing nations themselves, as a public weary of conflict after World War II were unenthusiastic about the potential conflict that would be a result of any repression of the nationalist sentiments that were beginning to grow in the colonized states.

Nevertheless, it can be argued that the process of decolonization is not as final as its definition suggests, in that the formal end of colonial rule might not necessarily result in genuine economic independence for the former colonies. Just because a country is nominally independent does not mean that it is immune to foreign influence. Indeed, some analysts (particularly those subscribing to *DEPENDENCY THEORY*) have argued that decolonization only took place when the colonial powers felt confident that their interests in the colony could be maintained without recourse to formal political control. In such a scenario, the former colonial relationship to all intents and purposes still remains.

In addition, countries that gained their independence through decolonization have not found it easy to take their place in the international community. The populations of the new states are rarely cohesive and typically include groups that have different languages or dialects, different religious beliefs and even a different history. Moreover, in some cases decolonization took place in a manner that did not ensure a peaceful transition to independence. For example, Great Britain pulled out of many of its former colonies without ensuring that the economic and political institutional machinery was in place to allow for a smooth transition from colony to former colony. This left behind an economic, political and bureaucratic vacuum and attempts to fill it led to an immediate internal class struggle in most former British colonies. The struggle to define the sharing of governmental power and its peaceful transition among the various governmental elites meant a greater level of class in-fighting and political instability in the former British colonies. This also served to keep much needed foreign investment away.

Nevertheless, these states have had a significant impact on international relations (IR), in particular on the progress of the UNITED NATIONS (UN). Former colonies make up the bulk of the General Assembly of the UN. Although this does not restrict the actions of the larger powers that are permanent members of the Security Council and possess a veto, it did mean that, during the *COLD WAR*, if either of the superpowers wished to appeal to world opinion they had to gain the agreement of a body whose membership did not necessarily share their preoccupations.

See also:

Brandt Report; Marxism-Leninism; world-systems theory

Further reading

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deflation, policies of

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ALISON M.S. WATSON

DECREASING RETURNS TO SCALE *see* diseconomies of scale

deflation, policies of

Deflation can be taken to mean both a reduction in the general level of prices in an economy and, more broadly, a reduction in the level of economic activity that takes place. In this latter case, deflation will lead to lower levels of employment and imports, as well as lower rates of increase for prices or wages. Tighter monetary policy (see **MONETARY POLICIES**), through a contraction of the money supply and/or an increase in the **INTEREST RATE**, can bring about deflation. This will result in a change in the capital account of a country's **BALANCE OF PAYMENTS** because higher interest rates in one country relative to another will attract investors from abroad who are seeking a higher return on their investment. Tighter fiscal policy, through an increase in taxation and/or a reduction in government spending, will also result in deflation.

A government would pursue a deflationary policy to reduce **INFLATION** and/or to improve a country's balance of payments. Deflation reduces demand for imports through a reduction in aggregate demand and tends to make exports more competitive by reducing or eliminating inflation. The danger is, however, that as consumers see prices falling they will stop spending in anticipation of a further decline in prices. This will eventually lead to a **DEPRESSION**.

Historically, deflation was important during the **GOLD STANDARD**, with some analysts viewing the arrangement as an engine of deflation.

Several leading economies also pursued deflationary policies in the early 1980s. Those states intending to join Europe's **ECONOMIC AND MONETARY UNION (EMU)** pursued deflationary policies in an effort to achieve the convergence criteria on inflation and budget deficits set out in the **MAASTRICHT TREATY**.

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ALISON M.S. WATSON

deindustrialization

Deindustrialization denotes the process of decline in the share of total employment and output accounted for by the manufacturing sector of a given territory's economy. There has been a decline in the manufacturing's share of total employment in most **ORGANISATION FOR ECONOMIC CO-OPERATION AND DEVELOPMENT (OECD)** economies since the 1973 oil crisis, but generally this has been compatible with an increase in total manufacturing output and rising living standards.

For many commentators, just as manufacturing once displaced agriculture as the principal source of employment during an earlier stage of economic development, deindustrialization now marks the transition from an industrial to a post-industrial economy, characterized by labour-intensive service industries. Deindustrialization is therefore to be welcomed as the positive outcome of changes in the pattern of trade specialization of a mature economy, as the consequence of a switch in consumption towards services and away from manufactured goods, or as the result of different rates of productivity growth in the manufacturing and service sectors.

For others, deindustrialization is a less benign trend. Given the strong positive correlation historically between growth in manufacturing productivity and output on the one

hand, and growth in overall productivity and per capita income on the other, deindustrialization has been regarded as a negative development, the consequence either of economic failure or, in the case of developing economies, of COLONIALISM and protectionism. In addition to potential balance-of-payments constraints, deindustrialization may adversely affect the competitiveness of an economy's service sector.

The debate about the causes and implications of deindustrialization for economic performance has been most vigorous in the United Kingdom, the first modern industrial economy, where the decline in manufacturing employment has been particularly pronounced and accompanied by stagnant manufacturing output, relatively weak manufacturing investment and poor productivity growth.

Deindustrialization in the UK has been attributed to a multitude of causes, including an anti-industrial culture; too much or too little state intervention; poor relations between both finance and industry, and between workers and management; and insufficient investment by government and business alike in both education and training, and in research and development. There has been little agreement about the causes and consequences of deindustrialization, but one Parliamentary Select Committee predicted that the UK's poor performance in manufacturing undoubtedly contained the seeds of major political and economic crisis in the foreseeable future (House of Lords, 1985: 56).

Other commentators are more sanguine about deindustrialization and its effects. Deindustrialization may indeed constrain future growth prospects if it results in declining terms of trade or a failure to exploit infant industries with high future productivity growth. However, as the example of Concorde testifies, a much greater danger to economic performance may lie in deindustrialization becoming a dangerous obsession which opportunistic politicians exploit to justify their attempts to pick winners, resulting in expensive and ultimately unsuccessful high-technology fantasies driven by industrial patriotism (Crafts, 1993).

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SIMON LEE

delinking

A term associated principally with world-systems theorist Samir Amin and with dependency writers, although the latter rarely use the term. Delinking is often misunderstood; it does not mean complete withdrawal, dissociation, disengagement or disconnection from any linkages with the outside world. Furthermore, as Amin stresses repeatedly, delinking is not synonymous with AUTARKY. It is, however, an ambiguous term which can lead to confusion. A better term may be relinking or reshaping external links.

Delinking means gaining a greater degree of control over the internal process of production and reproduction by transferring more decision-making power to the dependent nation. This also allows a greater degree of influence on external events themselves. According to WORLD-SYSTEMS THEORY, the centre countries impose or determine certain linkages on the periphery with the world economy and, in particular, with the centre. These are relations of domination which subordinate the periphery to the interests and requirements of the centre or developed country (DC). This has a negative impact on the periphery, as it disarticulates and distorts its development pattern reproducing the unequal and exploitative relations within the periphery or less-developed country (LDC), as well as leading to the continuing exploitation of the LDC by the DC through UNEQUAL

delinking

EXCHANGE and other mechanisms. This stunts the development potential of LDCs.

Delinking requires both transformations within a country or group of countries and changes in the international economic system. For most advocates of delinking, it means initiating a process of transition to socialism which abolishes the exploitative relations of capitalism as well as enhancing the social participation of the majority of the population who are excluded from decision-making processes. Delinking attempts to widen the scope for autonomy of nations and exploited classes. Delinking thus requires, and is a way of achieving, the restructuring of the world system. It is therefore a matter of forcing the world system to adapt by replacing the current unilateral adjustment of the periphery to the centre by mutual, reciprocal and egalitarian adjustment.

For Amin, delinking entails, first, the rigorous subordination of external relations to internal development objectives, rather than to the imperatives of world capitalist competitiveness and rationality; second, the political will and ability to introduce profound egalitarian reforms which enhance the economic, social and political power of the dominated classes or groups; and, third, it involves having the capability for technological absorption, creation and development so as to gain control over a major engine of growth and reduce dependence on external technology and MULTINATIONAL CORPORATIONS (MNCs) who monopolize it. Thus delinking is expected to enhance the capacity for AUTONOMOUS DEVELOPMENT.

The feasibility and success of delinking is influenced by factors such as the size of the domestic market, the resource-base available, the composition and geographical pattern of foreign trade, the availability of local skills and entrepreneurship, the degree of internal social cohesion, consciousness and support in favour of delinking, and so on. Furthermore, strengthening the unity of LDCs through regional and supra-regional cooperation and trade agreements will also enhance the possibility of successful delinking and for restructuring the world system. Delinking was a more feasible

proposition before the demise of the Soviet Union and other socialist countries, as they afforded a counter-hegemonic force to the capitalist centres and a source of support to those LDCs attempting to delink. It would not, of course, guarantee that the aims of the delinking proponents would be achieved, especially in regard to social participation and autocentric or autonomous development.

While Amin views delinking as a situation which can become permanent, for ANDRE GUNDER FRANK delinking can only be temporary as sooner or later it will be followed by reintegration at a more advanced stage into the world capitalist system, thereby consolidating its relentless expansion. Both Frank and Amin stress that overcoming dependence by means of a process of delinking requires a revolutionary process in which there is an internal transfer of power and an expansion of popular participation. Delinking and popular participation go hand in hand and one without the other cannot succeed, even on a temporary basis.

Finally, some critics of delinking argue that the success of the NEWLY INDUSTRIALIZED COUNTRIES (NICs) shows delinking to be a mistaken development strategy and that LDCs should increase their links and integrate themselves further with the world capitalist system. Undoubtedly the delinking thesis questions the outward-oriented development strategies historically followed by LDCs, be they as traditional primary-commodity exporting countries or, as in the contemporary instance of the NICs, as industrial-commodity exporting countries. It is argued that the traditional extroverted development-pattern of LDCs has led to their external EXPLOITATION and vulnerability (see VULNERABILITY, ECONOMIC). The NICs are seen as exceptional cases which cannot be generalized. Furthermore, in these critics' view, they are not a model for development as their EXPORT-LED GROWTH is based on cheap labour, authoritarianism and questionable technological development, and is not responsive to popular needs. The critics also question the neo-liberal interpretation of the success of the NICs, as it fails to recognize

the importance of the state and selective protectionism in this achievement.

See also:

disengagement; neo-liberalism

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CRISTÓBAL KAY

democracy and economic growth

Scholarly work on political and economic development has grown rapidly in recent years and has demonstrated increasingly sophisticated knowledge of both economics and political science. Researchers are engaging in an exemplary effort to bring the two fields into an integrated branch of the social sciences through modelling, empirical testing and in-depth case studies involving both qualitative and quantitative analyses. Systematically combining principles of economics and political science, the study of the relationship between economic growth and democracy has become the most promising research agenda in this area. Such works have not only been theoretically innovative, but also empirically meaningful. While economic growth has become one of the most important topics in economics

since the emergence of endogenous growth theories in the mid-1980s (see ENDOGENOUS GROWTH THEORY), research in democracy has also gained a tremendous momentum from the third wave of democratization that has swept the world over the last decade. A number of endogenous growth theorists incorporate in their models the possibility that government can play an important role within the production process. Therefore, scholars are able to study long-run economic growth from a new perspective – that is, through the examination of political mechanisms for economic incentives. Democracy, along with political stability, has been identified as possessing potential for significantly affecting the trajectory of economic growth in a nation.

Theoretical perspectives

Democracy has been both lauded as a vehicle for happiness and prosperity, and blamed for hampering capital formation and the long-term growth of nations. As Sirowy and Inkeles (1990) summarize, there are three broad perspectives of the effects of democracy on economic growth and development. Each of the three schools – the conflict school, the compatibility school and the sceptical school – offers a theoretical paradigm for the explanation of the role a political democracy plays in economic growth.

The conflict school of thought holds that democracy hinders economic growth, particularly in LESS-DEVELOPED COUNTRIES (LDCs). These scholars offer three assumptions in support of this claim. First, premature democracy exerts 'dysfunctional consequences' on growth. Second, democratic regimes are unable to implement the policies necessary for rapid growth. Third, democracy is incapable of pervasive state-involvement in the development process. Additionally, it has been argued that a nation's rapid growth requires autocratic control and reduced freedom, and that developing countries, in particular, cannot achieve rapid economic growth without a strong centralized government. Part of the literature on DEVELOPMENT advances the concept of 'antagonistic

growth', according to which democratic political systems are beset with some fundamental difficulties in simultaneously resolving redistribution conflict and pursuing long-run economic growth.

In contrast, the compatibility school of thought fundamentally opposes the assumptions of the 'conflict school' and contends that democracy enhances economic growth. Proponents of the compatibility thesis maintain that democratic governments in less-developed countries are best suited to foster sustained and equitable economic development. They hold that democratic processes, as well as the existence and exercise of fundamental civil liberties and political rights, generate the social conditions most conducive to economic development. Political and economic freedom enhance PROPERTY RIGHTS and market competition, thus promoting economic growth.

Finally, according to the sceptical perspective, there is no systematic relationship between democracy and economic development. The proponents of this school maintain that having a democratic government alone means very little for economic growth. Instead, they focus on institutional structures (for example, two-party versus multi-party systems) and government development policies (for example, IMPORT SUBSTITUTION versus EXPORT PROMOTION) which may vary independent of political systems. This perspective also implies that different political systems are capable of adopting essentially the same economic and industrial policy, thus leading to the conclusion that the effects of political systems on growth are negligible.

The theoretical disjunction, which underlies the three above paradigms, stems from using a set of entirely different assumptions to buttress the final claims. A theoretical impasse will ensue if these assumptions are clung to, without examining the circumstances by which some are closer to the truth than others. Breakthroughs in the evaluation of these claims must start with empirical evidence stipulated or implied by general theory.

Empirical evidence

In order to test the effects of democracy on growth, it is essential that scholars use common definitions of democracy and growth, regardless of their positions on the issue. Economic growth is typically defined as the annual growth-rate of real GROSS DOMESTIC PRODUCT (GDP) per capita or real GROSS NATIONAL PRODUCT (GNP) per capita, based on either exchange rates (see EXCHANGE RATE) or the purchasing-power parity method for cross-country comparison. Undeniably, economic growth is not equivalent to economic DEVELOPMENT, but the former is consistent with the latter. By contrast, the definition of democracy is somewhat problematic. J.A. SCHUMPETER emphasizes the procedural aspects of democracy, defining democracy as

that institutional arrangement for arriving at political decisions in which individuals acquire the power to decide by means of a comprehensive struggle for the people's votes.

(1942: 269)

In Schumpeter's procedural version, democracy is nearly devoid of normative values, such as the intrinsic utility of personal freedom and equality; an institutional arrangement for elections would be sufficient to qualify a society as democratic. Thus, the Netherlands – with its high degree of civil liberties and political rights – would be equivalent to Malaysia where personal freedom is routinely forfeited for the developmental goal of the state. In contrast to the relatively value-free conceptions of procedural democracy, some scholars emphasize the notion that democracy is value-laden, based on normative ideals. For instance, Sartori argues that

democracy is uniquely open to, and hinged on, a fact value tension. It can be said that only democracy owes its very existence to its ideal. . . . The term democracy, then, has not only a descriptive or denotative function but also a normative and persuasive function.

(1987: 8)

In line with this argument, the concept of liberal democracy intends to capture the intrinsic value of political freedom under democracy, as well as under the democratic rule of law. Bollen (1993) defines democracy as the extent to which a political system allows political liberties and democratic rule. In this sense, political liberties exist to the extent that the people of a nation have the freedom to both express political opinions in any media or form and to participate in any political group. Democratic rule exists to the extent that the national government is accountable to the general population and each individual is entitled to participate in the government directly or through representatives. It is this concept of *liberal democracy*, rather than procedural democracy, that has been utilized in research on growth and democracy.

Four indices for degrees of democracy have been frequently employed in the empirical studies of democracy and economic growth. They are Bollen's *liberal democracy* index, Gurr's *institutionalized democracy* index, and Gastil-Freedom House's *political rights* and *civil liberties* scores. None of them takes a dichotomous value to indicate either the presence or absence of democracy. Instead, these indexes treat democracy as a continuous variable, avoiding arbitrary decisions with regard to some borderline cases of democracy. This approach of operationalization studies the effect on economic growth of the *degree*, rather than the state, of liberal democracy. A problem in using the indices of degrees of democracy occurs in the investigation of democratic transitions, specifically when we have to pin down the cut-off point of a transition to democracy. Gasiorowski develops a data-set for four mutually exclusive types of political entities: democracy, semi-democracy, autocracy and transitional state, providing critical information for the studies of democratic transitions as a consequence of economic development.

While the four indices for the degree of democracy are highly correlated, showing the internal consistency of concepts and measurements, each has its merits and limitations. The strength of Bollen's liberal democracy index

lies in its theoretical coherence, but its usefulness is handicapped by the lack of observations in terms of the coverage of years as well as countries. Gurr's institutionalized democracy indicator has a long time-series and a wide selection of countries. Its main drawback is that when a political transition occurs, the variable is recorded as missing, providing no information regarding the level of political freedom of the country in that year. In the database by Gastil Freedom House, civil liberties scores are indicators of civil freedoms, but not a very satisfactory measure for political freedom. That the correlation of the civil liberties index with liberal democracy is relatively low compared to that of the political rights index with liberal democracy, indicates that some elements in the domain of liberal democracy are absent from the civil liberties measure. In sum, the political rights score is the most desirable individual index for indicating the *degree* of liberal democracy.

Parallel to the theoretical controversies on democracy and growth, cross-national quantitative studies have produced ambiguous and sometimes contradictory evidence. Some empirical studies have found no significant relationship between economic growth and regime type. Others have established a strong impact of democracy on growth. Yet others have ascertained only a weak positive effect of democracy on growth or even a negative influence of democracy on growth. Several recent regional studies, focusing on developing countries in sub-Saharan Africa, Latin America and Pacific Asia have also produced ambiguous findings (see Siemann, 1998, and Feng, 1998, for details). What causes these differences may stem from the selection of countries and years in a sample, and, most importantly, of control variables in the specification of a statistical model.

An appropriate study of the effect of democracy on growth should take into consideration, as control variables, all economic conditions that have been found important for economic growth in the empirical macroeconomics literature. Such variables include the initial level of economic development to

reflect the CONVERGENCE hypothesis, human capital accumulation to account for the spillover effect stipulated by endogenous growth theories and the amount of investment to capture the essence of the neo-classical economic growth models (see NEO-CLASSICAL ECONOMICS). Additionally, inflation, government consumption, international trade, income inequality and demographic variables (such as fertility or life expectancy) are also viewed as important determinants of growth. Without including these crucial control variables, an empirical study of the effect of democracy on growth risks mis-specification and, thus, biased results.

Furthermore, regardless of a positive or negative direct effect, democracy may have its indirect effects on economic growth through other channels. Such channels include political stability, education, investment, property rights and income distribution. For instance, the negative effect on growth of political instability can be significantly reduced by a democratic political system. While the direct effect of democracy on growth may be ambiguous, its indirect effects on growth – through its impact on major regular government change and political regime change – are positive. The former type of government change is defined as a power transfer that involves a change of the ruling party that has been accomplished under the constitution. The latter type of government change is defined as a power transfer that has been completed outside the constitutional framework. The empirical results indicate that democracy has a positive impact on major regular government change and a negative impact on regime change. Meanwhile, major regular government change has a positive effect on growth and political regime change has a negative effect on growth. Thus, democracy has an indirect positive effect on economic growth by inhibiting regime interruption and enhancing the capacity of the political system to adjust itself (Feng, 1997). Democracy therefore provides a stable political environment that reduces unconstitutional government change; yet, along with regime stability, democracy offers flexibility and the opportunity for major

government change within the political system. This combination of macro-political stability and micro-political adjustment is conducive to sustained economic growth and expansion. In addition, democracy has significant and positive effects on private investment, education, population growth, wealth equality and economic freedom, all of which generate conditions propitious for economic growth (Feng, 2001). Therefore, indirectly, democracy promotes long-run economic growth.

In terms of research design, economists tend to adopt a cross-country analysis, which requires averaging the values of the relevant variables for a fairly long period of time. By contrast, some political scientists are likely to employ a time-series cross-country strategy, of which the unit of analysis is usually based on country per year or country per five-year intervals. This methodological bifurcation is caused by a difference in research interests between economists, who opt to study *long-run, aggregate* relationships between economic growth and political institutions, and political scientists, who emphasize the *short-run, dynamic* effects on economic development of political systems.

The major advantage of the aggregate approach is that a long-run pattern can be observed and analysed. Its drawback is that short-term dynamic change is discounted. The time-series approach is designed to study the effects of political dynamics on growth. Its problem, as Barro (1997) points out, is that the precise timing between growth and its determinants is not well specified at the high frequencies characteristic of business cycles. Under these circumstances, a time-series analysis risks mis-specification. Another potential benefit from adopting a time-series approach lies in taking into consideration the effects unique to the country. The removal of these fixed effects is often achieved by first differentiating all time-series variables in the equation. Doing so, however, tends to cause the loss of cross-country information and to result in the misrepresentation of the lag structure (Barro, 1997). Despite the potential pitfalls mentioned above, time-series analyses do have an advan-

tage when studying the dynamic change of the relationship between political and economic development, especially when it comes to democratic transitions, which are dynamic changes from one kind of political system to another.

The effect of economic growth on democratic transitions

The other major topic concerning democracy and growth centres on the consequences of economic development on the transition and consolidation of democracy. The single most important thesis in this area is contained in the modernization argument, attributed to Lipset (1959), that postulates that development or modernization will lead to democracy. Lipset maintains that economic development increases education and empowers the middle class, providing a socio-political structure conducive to democratic transitions. The modernization thesis (see MODERNIZATION THEORY) is thus an alternative interpretation of democratic transitions to the political agents thesis that emphasizes the active engagement and interaction between political actors as the fundamental causes of democratization.

Empirical evidence is generally consistent with the modernization thesis, though a few studies cast doubt on its universality. Some scholars also maintain that economic development does help newly emerging democracies consolidate themselves, reducing the likelihood of a reversal to autocracy, though they find little evidence that economic development leads to democratic transitions (see Kugler, 1999, for details).

Among a multitude of possible determinants for democratic transitions, some scholars regard economic development as such a critical determinant for political regime change that they treat it as a requisite for democratic transitions. Such a view confuses a necessary condition with a sufficient one. While economic development is important for a transition to democracy, factors other than economic prosperity may contribute to such transitions. Some European societies, such as ancient

Greece, began to practise principles of democracy while their economies were still backward. Cross-country data show that a nation with a low level of income inequality stands a better chance for a switch to democracy than a nation where income inequality is high, even when the former has a low level of development. Furthermore, some scholars argue that cultures, traditions and ideologies contribute to democratic transitions. Empirically, nations with some past democratic experience are more likely to have a current democratic transition than otherwise, while the threshold for a democratic transition in some Muslim or Asian Pacific nations is relatively high, keeping all other factors constant. Finally, international actors can be instrumental in installing a democratic system on foreign soil, regardless of the latter's economic development and wealth distribution. In sum, while economic development generates conditions within the country conducive to the establishment of a democratic government, other factors also foster democratic transitions. Therefore, it is appropriate to treat economic development as a sufficient condition for democratic transitions. As long as the economy expands, the likelihood of a democratic transition grows.

Despite an increasing number of empirical works on democratic transitions, 'theoretical models of the effect of prosperity on democracy are not well developed' (Barro, 1997: 51). Few studies have both formalized and statistically tested the dynamics of democratic transitions. The symposium edited by Kugler (1999) presents an ambitious attempt to fill in this lacuna. The works presented in the symposium demonstrate that economic growth and development shape the agents' sense of welfare and restructure their preferences; meanwhile, interactions between the autocratic government and the pro-democratic opposition generate political dynamics that condition democratic transitions.

More importantly, the level of economic development and the degree of democracy can reinforce each other. In addition to the indirect positive effects of democracy on economic growth, economic growth promotes democratization and democratic transitions. The evidence

shows that economic growth contributes to major regular government change and decreases political violence. Meanwhile, major regular government change promotes democratic values, whereas political violence tends to reduce democratic stability. Therefore, economic growth in the long run creates conditions for the peaceful evolution of an autocracy into a democratic state and facilitates the consolidation and expansion of the democratic political system.

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YI FENG

demographic transition

Demographic transition is a theory used by demographers and social researchers for explaining the pattern of change in population structure as society advances from primitive to higher stages of socioeconomic DEVELOPMENT. The structure of population change in demographic transition is defined by definite patterns explained by the age and sex composition of the changing population at each stage. Coale defines demographic transition as

a specific change in the reproductive behaviour of a population that is said to occur during the transformation of a society from a traditional to a highly modernized state.

(Coale, 1989: 16)

Stages of demographic transition

Four standard stages of demographic transition are usually considered as the sequencing of population change in any society. There is also a dynamic version of demographic change in relation to socioeconomic development. We will examine these two concepts below.

In the primitive first stage of socioeconomic development, the fertility rate remains high while the infant mortality rate remains high as well. The net result is a rate of growth of population that remains at a low and static level as a society passes through this primitive stage. During this stage of demographic transition, low levels of economic, technological and social change are caused by low human resource development that otherwise could disseminate knowledge of prenatal caring and adequate medical care.

This primitive stage of demographic transition is also found to be associated with rudimentary agricultural economic activity. Consequently, a paternal family structure with low female labour-force participation characterizes the division of labour between home and work. Low female labour-force participation explains an increased fertility rate at this stage. But a lower female participation rate is

also causally related to low human-resource development. Consequently, the first stage of demographic transition is explained by cause and effect in a primitive agricultural paternal society characterized by low female labour-force participation, low human-resource development and the shortage of prenatal caring knowledge and medical facilities.

The second stage of demographic transition is characterized by the fertility rate being higher than the mortality rate. This happens due to improving medical care and better human-resource development. Improved medical care causes infant and prenatal mortality to decline, while human resource development leads to planned parenthood. The population is now found to grow at a stable rate. A stable population structure enhances labour-force activity with a higher proportion of younger and productive workers in it.

In the socioeconomic sense, this stage of demographic transition brings about a development focus on industrialization and away from agriculture. With such an economic transformation, the demands of an on-coming technology now necessitate human-resource development and division of labour in activities outside the home. Such socioeconomic forces generate increased economic activity, which in turn enhances family earnings and the resulting demand for higher standards of living. Economic boom follows a stable population change. It is caused by the mobilization of savings, human-resource development and growing possibilities of TECHNOLOGICAL CHANGE together with higher resource availability. Now family choices between procreating children and demanding other amenities for a higher standard of living, including caring for self and children, determine and reinforce the second stage of demographic transition.

The third stage of demographic transition is characterized by a decline in the fertility rate, while the mortality rate may remain constant or increase marginally as the population ages. On one hand, increased division of labour outside the home – following an educated female labour force, improving economic prospects, demand for higher standards of living

and the emerging technological advancement offering time-saving at home – enhance the female labour-force participation rate; on the other hand, smaller family size and fewer marriages now cause the population to age. Ageing is followed by a constant or increasing mortality rate, even with the advanced medical care in this stage of development. A static rate of growth of population causes the old-age dependency ratio to increase.

On the socioeconomic side, the third stage of demographic transition is characterized by the diversion of savings into consumption, caused by increased demand for social and medical services by the elderly. An ageing population also increases the claim on public retirement benefits, while less social product is being generated as a result of a smaller proportion of the young workforce in the population structure. The diversion of national savings to finance social services and retirement demands lowers the growth rate of the economy or causes inequitable allocation of productive resources into capital-using (as opposed to labour-using) technology. Higher unemployment resulting from such changes, caused by the adverse relationship between lower national savings and high retirement demand, reinforces the demand for social security, causing an inequitable tax burden on the young. Thereby, the third stage of demographic transition shows a combination between economic inefficiency and an inequitable distribution of economic resources within the population structure.

The fourth stage of demographic transition has become of particular interest in relation to the present incipient decline and increased ageing of populations in the industrialized nations. This stage of demographic transition is caused by the mortality rate being higher than the fertility rate. It is a consequence of accentuated ageing, which in turn results in a declining proportion of women of child-bearing age. Furthermore, an increase in the proportion of females in the population, together with the declining fertility rate, in these circumstances enhances the effect of increasing mortality rate. A combination of

demographic transition

these demographic situations characterizes an incipient decline in population size and accentuates its ageing.

These characteristics transmit adverse effects on the economy. The incipient decline of population intensifies the adverse economic conditions caused in the third stage of demographic transition. The cost of public services and social security provisions increases. This has to be recovered by increased taxes. Higher taxes cause disincentive to work, a higher propensity to leisure and added inefficiency in the production of social product. Clark points out:

The cost of national pension systems rises with population ageing because a greater fraction of the population is receiving benefits and a smaller fraction is working and paying taxes to support the system. This relationship has become one of the principal public policy issues associated with population ageing.

(Adapted from Clark, 1989)

A continuous version of demographic transition

Demographers have treated the theory of demographic transition in terms of closed progressive stages of population change and their associated socioeconomic effects. But beyond this kind of treatment is the need for demographic transition to be studied as a continuous interrelationship between population change and socioeconomic development. Such a theory can be formalized in terms of a dynamic circular interrelationships between demographic variables and economic variables. Important in such interrelationships is the causality between population structure and the savings ratio or rate. Population structure is defined here by its age and sex composition, as caused by continuously variable fertility rates, mortality rates and migration rates. Demographic transition on the other hand, ignores the effect of migration rate on a closed population structure. Instead, a long-run intrinsic rate of birth is taken as the dominating

variable for describing the structure of change in a closed population.

With the introduction of migration rate and an open population, there is every reason for an ageing population and any of the stages of demographic transition to revert to a different stage from that given by the sequential patterns of demographic transition outlined above. For example, it is interesting to follow today's demographic change in the United States in terms of the dynamics being contributed by a rapidly increasing immigrant population, even when the population growth-rate of white Americans is declining. The case is similar in Western Europe, with its burgeoning immigrant population bringing with it all the characteristics of the second stage of demographic change, even though the ageing population of native Europeans is experiencing an incipient decline.

With regard to economic development, an increased saving ratio generated by an enlarged immigrant population enhances technological change, economic efficiency through an active labour force, an increase in enterprises and increased volume of government revenues from taxes. Thereby, the adverse economic conditions of the third and fourth stages of demographic transition can be reversed and mixed with non-trend dynamic consequences. The US and Canada are examples in which a stable demographic structure of the immigrant populations has contributed immensely to economic growth, enterprise and technological change through their effective mobilization of savings.

With such dynamic effects of resource mobilization on enterprise, the causal interrelationship between fertility rate and the saving ratio is found to be positive. Besides, the mortality rate does not increase, for the medical care and the younger population available within a segmented ageing population reverses the third and fourth stages into the second stage of demographic transition. A positive interrelationship is established between the inductive effect of immigration rate on savings and fertility rate, while the mortality rate remains low or constant.

As the cultural dynamics of the immigrant

population further enhances such a positive socioeconomic interrelationship, a dynamic concept of demographic transition provides an explanatory theory of continuous demographic transitions in terms of the savings rate and its causal relationship with increasing fertility rates and enterprise. Kelley (1973) points out that the effects of an ageing population on national savings depends upon the age-specific savings rates. Neither the age-structure nor the savings rates remain trapped in the strict stages of demographic transition.

Population change and family-planning policy

The two different views on population dynamics in relation to socioeconomic development, one from the side of the demographers and the other from the side of economists, can result in disparate views on public policy relating to family planning. An argument has been made that large populations, like those of Bangladesh and India, are a cause of demand pressure on social services. The result is then seen to be malnutrition, low entitlement and economic deprivation. Yet this population debate, when applied to Indonesia and China, does not support a similar inference. The difference between the two experiences lies on the role that appropriate forms of resource mobilization and choice of technology have played in realizing economic growth in these two sets of countries. There is also the issue of sound public policies playing constructive role in guiding families towards informed choices on family size in the light of the envioning socioeconomic issues. In all of these, the mobilization of savings into productive investments and cultural factors together determine the dynamic forms of interrelationships between economic variables and the fertility rate.

In the same population debate relating to family planning, the sequential stages of demographic transition as the basis for public-policy formulation on family planning would ignore the experience of the two sets of countries respecting their choices of developmental regimes. By contrast, a good under-

standing of the development-oriented demographic transition enables public policy-makers on family planning to examine socioeconomic factors that have causal relations with demographic transition.

In the study of international political economy (IPE), a combination of the closed-population concept and the dynamic concept of demographic transition should be studied together to understand the developmental context of population change. Without this contextual view, the problem of efficient allocation of resources, and its equitable use in alleviating poverty and promoting entitlement, will not be understood either for the study of development or for policy-making.

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MASUDUL ALAM CHOUDHURY

demographic trends

Demography (the study of population) has long employed a historical approach to study population changes over time. Factors monitored in this way may include population numbers, age-distribution, life-expectancy, nutrition, birth-rates and fertility; height, body weight and other human biological variables; cultural and religious factors; the proportion of a population speaking a specific language, and ethnic self-identification. When plotted against a timescale, these variables can be used to derive patterns of change (demographic trends), reflecting change in one or several of these factors. Data for such analysis is usually derived from censuses and other historical texts, but (where these are unavailable or incomplete) anthropological records and archaeological data are often employed. Using these data, demographic trends can be traced for millennia: for example, an overall logistic growth curve for the global human population since the origins of farming and settled habitation (sedentism) in the Neolithic period can be plotted. These trends can be interpreted to provide policy-relevant information, especially regarding economic, medical and environmental issues. Recently, their potential significance for assessing future risks in INTERNATIONAL SECURITY has also been stressed by several analysts.

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KEN DARK

demonstration effect

The international demonstration effect refers to the imitation by DEVELOPING COUNTRIES of the higher consumption standards that are being exhibited ever more rapidly, through a growing number of channels, by the advanced market economies. Imitative behaviour of this kind may induce an increase in the supply of labour, as relatively poor consumers strive to afford the goods thus exhibited, but it may also cause a decline in the savings rate as the propensity to consume rises, imports from the developed countries increase and products that are inappropriate to circumstances in the developing countries are used.

See also:

dependence; globalization

JEFFREY JAMES

dependence

'Dependence' is a widespread and potentially serious condition within the international political economy. It is also distinct from the more specific and more theoretically laden concept of dependency (or *dependencia*).

Dependence in international relations (IR) can best be defined in the following terms:

Dependence exists for any actor when a satisfactory outcome on any matter of significance for that actor requires an appropriate situation or development elsewhere.

(Jones, 2000: 100)

Thus, a country's oil dependence means that its continued importation of oil requires the extraction of oil elsewhere, and its safe and reliable shipment to the dependent country.

Levels of dependence vary considerably among countries, on different issues and under varying conditions. Moreover, any given country may be dependent on other countries for many valued conditions, financial resources

and/or imported materials, while having other countries dependent on it for the supply of commodities that they, in turn, need and value. Thus the United States has become increasingly dependent on imported oil, while many other countries (including many oil exporters) remain dependent on the United States for the supply of advanced military equipment and munitions.

The variation in levels of dependence from issue to issue and from country to country, highlights the need for criteria by which to differentiate dependencies of varying levels of significance. The now conventional distinction between sensitivity and vulnerability offers one approach to such differentiation (see SENSITIVITY, ECONOMIC; VULNERABILITY, ECONOMIC). The distinction between the two, as is made clear in the relevant entries in this encyclopedia, rests on a country's exposure to costs imposed by foreign conditions and/or developments before and after the time and opportunity for policy changes designed to reduce, or end, the level of the relevant condition of dependence. In practice, however, sensitivity and vulnerability are not qualitatively distinct conditions, but outer points along a multifactorial continuum of costs and the relative availability of ameliorative policy options.

Conditions of dependence are not confined to bilateral relationships. A country may be dependent on a foreign source of a particular commodity, even when that commodity is widely available within the world economy. Bananas are thus widely grown within the Caribbean, Central America and the Canary Islands, but this diversity of sources of supply does not reduce the dependence of European banana-consuming countries. Diversity of supply does, however, reduce the extent to which the dependence of any one country or group of countries is open to EXPLOITATION by the supplier(s).

Within INTERNATIONAL POLITICAL ECONOMY (IPE) much of the significance of dependencies lies in their association with differentials of international POWER and influence. Where a country is dependent on one other country for the supply of an essential commodity, good or

service, it may be vulnerable (in the conventional sense of the word) to pressure from the supplying country. Patterns of dependence are rarely even and balanced within the international political economy and where one country is less dependent on another than the other is dependent on it, then it may be able and willing to exploit that imbalance for its own ends. Asymmetries and imbalances in bilateral patterns of dependence are not the only source of potential difficulties for countries, however. More diffuse patterns of dependence can also create problems, as exemplified by the problems that many DEVELOPING COUNTRIES have experienced as a result of their general dependence on the international financial system for inflows of finance – whether in the form of inward investment or multilateral AID.

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R.J. BARRY JONES

dependency theory

Given the multiplicity of writings on dependency theory it is useful to distinguish between a structuralist and Marxist position. The following aspects differentiate these two positions. First, they are rooted in divergent theoretical frameworks: Marxism (see MARXISM–LENINISM) in one case and structuralism in the other. Second, the Marxist perspective is far more critical of orthodox economic and sociological theories: neo-classical and modernization theory respectively (see MODERNIZATION THEORY; NEO-CLASSICAL ECONOMICS). Third, there are political differences. The Marxist dependency writers characterize the local bourgeoisie as non-progressive and unable to overcome UNDERDEVELOPMENT

dependency theory

and DEPENDENCE. They reject the structuralists' claim that a populist political alliance between the local bourgeoisie and the popular sectors will be able to reform the international economic system and thereby resolve the problem of dependence. For the Marxists, only a socialist revolution can resolve the problems of dependence and underdevelopment. This, however, is seen as utopian by structuralists.

Although there are different streams within dependency theory, they share a common view on the meaning of dependency. For example, Osvaldo Sunkel's structuralist definition of dependency is very similar to Theotonio Dos Santos' Marxist definition, as both emphasize INTERDEPENDENCE and the absence of autonomous development in dependent countries:

Development and underdevelopment can therefore be understood as partial structures, but interdependent, which form a single system. A principal characteristic which differentiates both structures is that the developed one, to a large extent by virtue of its endogenous capacity of growth, is the dominant, and the underdeveloped, due in part to the induced character of its dynamic, is dependent.

(Sunkel, 1973: 136)

Dependence is a *conditioning situation* in which the economies of one group of countries are conditioned by the development and expansion of others. A relationship of interdependence between two or more economies or between such economies and the world trading system becomes a dependent relationship when some countries can expand through self-impulsion while others, being in a dependent position, can only expand as a reflection of the expansion of the dominant countries, which may have positive or negative effects on their immediate development. In either case, the basic situation of dependence causes these countries to be both backward and exploited.

(Dos Santos, 1970: 76)

Both dependency positions also share the

view that underdevelopment, or the pattern of development of dependent countries, is the particular form which capitalist development takes in these countries. They also agree that dependency originated when these countries were forcefully incorporated into the world capitalist system by the dominant countries. They concur that, in order to understand the internal dynamics of Third World countries, it is necessary to examine their relationships with the world capitalist system. Thus, underdevelopment is not an historical stage through which developed countries (DCs) passed, as argued by stage and modernization theorists like W.W. ROSTOW. As Sunkel puts it for the structuralists: 'Development and underdevelopment ... are simultaneous processes: the two faces of the historical evolution of capitalism' (1972: 520). Likewise, ANDRE GUNDER FRANK writes for the Marxists that:

The now developed countries were never *underdeveloped*, though they may have been *undeveloped*. ... Contemporary underdevelopment is in large part the historical product of past and continuing economic and other relations between the satellite underdeveloped and the now developed metropolitan countries.

(Frank, 1966: 18)

(See also UNDERDEVELOPMENT THESIS.)

Structuralist perspective

It is the failure of the inward-directed development strategy (see INWARD-LOOKING DEVELOPMENT) to achieve national economic autonomy which led some structuralists to embrace dependency theory. Key contributors to the structuralist perspective on dependency are Sunkel, Celso Furtado and Fernando Cardoso, among others. Each emphasizes different aspects of the dependency relationship.

Sunkel focused on national disintegration. He criticized Latin America's IMPORT SUBSTITUTION INDUSTRIALIZATION (ISI) process for its inability to reduce external dependence and,

on the contrary, for even increasing external dependence. First, the vulnerability to fluctuations in foreign exchange increased as these countries failed to diversify their exports and continued to rely on the export of one or more primary products whose prices in international markets are notoriously volatile. Second, as foreign-exchange earnings did not grow fast enough to sustain the development process, foreign debts burgeoned, making these countries financially dependent on their international creditors. Finally, the industrial sector increasingly became foreign-owned, putting an additional strain on the availability of scarce foreign exchange as profits and payments made for royalties and technical services, as well as control over the most dynamic sectors of industry, were transferred abroad.

Sunkel advocated a 'national development policy' which, however, did not imply breaking away from the world capitalist system but reforming it. Such a policy meant expanding and diversifying exports, reforming the traditional agrarian structure, and redirecting the industrialization process by developing a capital-goods sector and producing for export. In his view, transnational capitalism created a NEW INTERNATIONAL DIVISION OF LABOUR (NIDL) which was leading to national disintegration in dependent countries. As transnational conglomerates began to take over the commanding heights of the economy, they were driving a wedge into national society. While a minority of the country's population was being integrated into the transnational system and received some of the spoils, this was at the cost of national disintegration. Each social group was being fragmented into those who were incorporated and those who were excluded or marginalized.

These forces of GLOBALIZATION were leading to the crisis of the nation-state: at the economic level, by the domination of transnational corporations; at the cultural and ideological level, by the absorption of foreign conspicuous consumption patterns, and, at the level of development policies, by the pressure of transnational interests in favour of capital (especially foreign) and high-income

groups. Sunkel lamented the desertion of the local bourgeoisie into the hands of transnational capital. By becoming a COMPRADOR bourgeoisie, they excluded the possibility of self-sustained national development and no longer aspired to reform the asymmetrical nature of the international capitalist system.

Turning to Furtado, he stressed the negative influence of the centre countries on the consumption habits of the periphery by turning them into 'dependent patterns of consumption'. This, in his analysis, was the key factor that explains the perpetuation of underdevelopment and dependence in the periphery. A vicious circle was at work because the higher the rate of growth, the more intensive the dependent relationship became. The demand for an increasingly diversified consumption pattern by the high-income groups generated an equally diversified industrial consumer-goods production pattern. The technology for producing these products in the periphery came from the centre countries, largely from multinationals. Such technology is very capital-intensive, thereby furthering income concentration and perpetuating the structural surplus of labour. These increasing income inequalities intensify even further the dependent patterns of consumption and so the vicious circle of dependence is perpetuated.

The Brazilian sociologist and politician Fernando Henrique Cardoso is one of the key contributors to the dependency vision. Together with Enzo Faletto, he wrote one of the classic books on dependency. In their pioneering book, Cardoso and Faletto analyse how the changing relationship between internal and external factors has shaped the development process of Latin America from the early 'outward expansion' as newly independent nations in the nineteenth century to the present period of internationalization of markets and the 'new dependence'. This interaction between internal and external elements forms the core of Cardoso and Faletto's characterization of dependence. They seek to explore diversity within unity in development processes, contrary to Frank's search for unity within diversity in history (see below). Dependence is

not regarded simply as an external variable, as they do not derive the internal national socio-political situation mechanically from external domination. Although the limits for manoeuvre are largely set by the world system, the particular internal configuration of a country determines the specific response to the same external events. Thus, they do not see dependency and imperialism as external and internal sides of a single coin, with the internal reduced to a reflection of the external. They conceive the relationship between internal and external forces as forming a complex and interconnected whole.

Cardoso had a dynamic conception of dependency and therefore disagreed with the stagnationist position of dependency-thinkers like Furtado, Marini and Frank. To highlight his particular view of dependency he coined the term **DEPENDENT DEVELOPMENT**.

Marxist perspective

The Marxist theory of dependency arose out of a realization that **KARL MARX** never fully tackled the colonial question, being concerned with developing a theory of accumulation and development for the then most advanced capitalist countries (see **COLONIALISM**). While the classical Marxist theory of imperialism addressed the new stages and aspects of capitalism, it was mainly concerned with the imperialist countries and had little to say on the underdeveloped countries, a gap which the Marxist dependency theorists hoped to fill. Furthermore, they are critical of its progressive view of capitalism and, particularly, of foreign capital in underdeveloped countries. For these reasons the Marxist dependency analysts are sometimes referred to as neo-Marxists (see **NEO-MARXISM**). Despite these critical remarks, they considered the classical Marxist theory of imperialism to be a useful starting point for their analysis of dependency, as they shared its world-economy perspective, its view on the centrality of monopoly capital within the world capitalist system, and its emphasis on the international division of labour and the UN-

EQUAL DEVELOPMENT of international economic relations.

It was only after World War II, with the national liberation movements and decolonization, that Marxists turned their attention to the **THIRD WORLD**. Orthodox Marxists had not attempted to uncover the laws of development of the underdeveloped countries, as they had not questioned Marx's proposition that these countries would sooner or later follow the same path as the advanced industrial capitalist countries and that the laws of capitalist development were valid for both developed and underdeveloped countries. But, for Marxist dependency writers, a key theoretical problem was how to explain the different development process of the underdeveloped countries. The writings of **PAUL BARAN** exercised a major influence on dependency thinkers, especially his thesis that underdevelopment is rooted in the capitalist development of the imperialist countries, that underdevelopment and development are the common results of a worldwide process of capital, and that the national bourgeoisie in **LESS-DEVELOPED COUNTRIES** (LDCs) is incapable of uprooting underdevelopment.

No monolithic or single Marxist theory of dependency exists: rather, there are numerous strands. Among the Marxist dependency writers, Ruy Mauro Marini made the most systematic theoretical effort to determine the specific laws which govern the dependent economies. Marini's central thesis was that the basis of dependence involves the over-exploitation or super-exploitation of labour in the subordinate nations (see **EXPLOITATION**). By over-exploitation of labour, he meant that labour power was remunerated below its value (see **LABOUR THEORY OF VALUE**; **MARXIAN ECONOMICS**). This over-exploitation of labour arose out of the need of capitalists to recover part of the fall in profit rates as a consequence of **UNEQUAL EXCHANGE** as value was transferred from the periphery to the centre countries. Thus, over-exploitation helped to compensate for unequal exchange. In turn this over-exploitation of labour hindered the transition from absolute to relative surplus value (see

VALUE THEORY) as the dominant form in capital-labour relations and the accumulation process in the periphery, thereby underpinning their dependence. The periphery contributed decisively to the centre's capital accumulation by exporting increasing quantities of primary products and cheap food to them from the mid-nineteenth century.

According to Marini, the circuit of capital in dependent countries differs from that of centre countries. In dependent countries, the two key elements of the capital cycle – the production and circulation of commodities – are separated as a result of the periphery being linked to the centre through the over-exploitation of labour. Production in LDCs does not rely on their internal capacity for consumption but depends on exports to the DCs. Wages are kept low in the dependent countries because the workers' consumption is not required for the realization of commodities. Thus, the conditions are set for the over-exploitation of labour, especially if a sufficiently large surplus population exists.

In the dominant countries, meanwhile, the two phases of the circulation of capital are completed internally. Once industrial capital has established itself in the advanced countries, capital accumulation depends fundamentally on increases in labour's relative surplus value through technical progress. The resulting increase in labour productivity allows capitalists to afford wage increases without a fall in their profit rate. This rise in the workers' income fuels the demand for industrial goods and so the cycle continues.

Industrialization does not fundamentally alter the model of capital accumulation in dependent countries, which continues to rely on the over-exploitation of labour. Similarly to Furtado, Marini argued that the ISI process is geared towards satisfying the upper-income groups' demand for industrial consumer goods. Thus the realization of capital does not depend on workers' consumption and the industrial bourgeoisie is not compelled to introduce technical progress to reduce the value of labour and increase surplus value, as happens in DCs. In other words, industrial production does not stimulate the creation of an internal mass

market, as industry's profit rate depends on the over-exploitation of labour and low wages. The inward-directed development model (see INWARD-LOOKING DEVELOPMENT) enters into crisis when the industrialization process advances from the production of consumer goods to intermediate- and capital-goods, which are far more capital-intensive industries. In order to overcome this crisis, it is necessary to increase the intensity of capital accumulation, as well as to open up new markets. But the increasing demands for higher wages and the growing strength of the working class jeopardize the requirements for a higher rate of capital accumulation. As populist governments are unable to contain the growing working-class pressures on the system, the dominant class calls for repressive measures which only authoritarian governments can deliver (see BUREAUCRATIC AUTHORITARIANISM).

Marini claimed that, in the case of Brazil, this new political economy took the form of sub-imperialism, which can only be reached at the stage of monopoly and finance capital in big dependent countries. Sub-imperialism attempts to resolve the market problem, arising from the insufficiency of the internal market (see UNDERCONSUMPTION) through the following three policy measures: first, the promotion of industrial exports; second, the further concentration of income, and, third, increase in the state's demand for consumer durables and capital goods by expanding, *inter alia*, the arms industry, the state and military personnel, and the country's infrastructure. It is sub-imperialism, rather than imperialism, because Brazil does not possess a technological base of its own and is not in a position to dispute the dominant countries' control over the world market. Consequently, the Brazilian bourgeoisie enters into a partnership with international imperialism whereby foreign capital is provided with the internal conditions for expanding investment and profits in Brazil, in return for access to advanced technology and the world market controlled by the monopolies of the DCs. In Marini's schema, sub-imperialism and the over-exploitation of labour are closely linked. Indeed, the whole edifice of sub-imperialism

rests on the over-exploitation of labour, which is required to compete in the international market to attract foreign capital. Marini's concept of sub-imperialism has some similarities with Wallerstein's notion of SEMI-PERIPHERY.

Theotonio Dos Santos was one of the most prolific dependency authors and his ideas present some interesting differences to those of Marini and Frank. For Dos Santos, dependence was firmly rooted in economic factors of which technological dependence was the key. The distinctive aspect in Dos Santos' analysis of dependency is his discussion of the capital-goods sector. In common with other dependency writers, Dos Santos argued that – while the ISI process boosted the internal economic cycle – it did not transfer decision-making to inside the country, as industry was controlled by foreign capital. For Dos Santos, dependence is internally contradictory. As the industrialization process advances into the intermediate- and capital-goods sectors, the economy acquires the technical capacity to be self-sufficient and dependence ceases to be an objective necessity. Thus, the process of internationalization has a liberating face as well as a dependent face. Consequently, it is possible to overcome economic dependence if the dependent economies obtain a high degree of productive autonomy. If they are able to develop an important capital-goods sector, then foreign capital will lose its capacity to determine the character of their development. However, this process of expanding productive autonomy is very limited for the present, due to political constraints. According to Dos Santos, foreign capital is able to prevent the development of a significant capital-goods sector because of its political control over the dependent countries.

Although the concept of dependence is best-known to an English-speaking audience through the work of Frank, he was not one of the first to use the term dependence. Frank's main contribution to dependency analysis is found in his central idea of the development of underdevelopment. His notion of underdevelopment, in particular, explicitly states that it was

the capitalist development of the now DCs which engendered the underdeveloped structures in today's LDCs, and which continues to reproduce them.

One of Frank's major theses is that the closer the ties between the metropolis and the satellite, the more intense the development of underdevelopment. He argued that when these ties were weakened, as during the world crisis of the 1930s, the bourgeoisie in these dependent countries were able to pursue more nationalist and autochthonous policies which strengthened the process of development rather than of underdevelopment.

He emphatically rejected the idea that dependence was only an external condition, as it is closely linked with the internal class structure. He thereby rejected the thesis held by the modernization theorists and structuralists that the national bourgeoisie could present a nationalist or autonomous way out of underdevelopment. Such a solution did not exist precisely because dependence was integral and rendered the bourgeoisie itself dependent. He dismissed such a dependent bourgeoisie as a 'lumpenbourgeoisie', because they were only capable of bringing about a 'lumpendevlopment'. For Frank, the choice facing dependent countries is between capitalist underdevelopment or socialist revolution.

Frank's writings are best considered as belonging to the world-systems theory to which he, together with Samir Amin and IMMANUEL WALLERSTEIN, has made such a vital contribution. Frank's work has been extremely influential all over the world and his prolific and polemical writings helped to popularize the dependency vision. However, the identification of dependency theory, especially in the Anglo-Saxon world, with the work of Frank has led to a one-dimensional view of it.

Debates and critiques

Dependency theory has generated many controversies and has been much criticized. While some critics take issue with particular aspects of dependency analysis, many reject the approach altogether. In substance, critiques

have been based on theoretical, methodological, empirical and political grounds. Whatever its shortcomings, few social scientists concerned with international political economy (IPE) and development studies have remained indifferent to dependency. Indeed, the critical literature has become so vast that at times it loses sight of the original dependency authors. A shortcoming of many critiques in the English-speaking world has been their excessive focus on the work of Frank. This had the unfortunate consequence of precluding exploration of non-Frankian dependency and important differences between dependency writers have thereby been overlooked.

A frequent criticism is that dependency analysis exaggerates the power of external forces and downgrades the internal forces which shape development in LDCs. Although many dependency theorists, mainly of a structuralist kind, began by characterizing dependence as an external phenomenon, their position shifted. For most, dependence is a dialectical unity between, and a synthesis of, external and internal forces. Underdeveloped countries are seen as having their own internal dynamic which can only be comprehended within the matrix of the international system. This is the *raison d'être* of dependency analysis and thus the critique is partly misplaced. Certainly the way external and internal forces interact needs to be specified more precisely.

However, some critics even invert the dependency thesis by arguing that it is the nature of Third World social formations which determines, in the last instance, the forms of their linkages with the world capitalist system. Others argue that the very dichotomy of internal and external needs to be transcended. Frank (1978: 253) aimed to achieve this by adopting a world-system approach in which the question of internal or external determination becomes irrelevant as the analysis is concerned with 'a single process of accumulation and the development of a single world capitalist system'.

Some critics have attacked the globalist dogma in dependency and world-system theories which denies the capability of Third World countries to redefine their relations with

the dominant countries. But this pointed criticism of the tyranny of globalism is more appropriate to world-system theory than to dependency analysis. Many of these criticisms mistakenly assume that most dependency writers hold the view that external factors were the prime determinants of underdevelopment and dependence. This is not the case as, for example, Dos Santos distinguished between 'conditioning' external factors and 'determining' internal factors, and Cardoso constantly stressed internal relations as being crucial for understanding dependent development.

The dependency thesis, that underdevelopment or dependence originates from the incorporation of subordinated or dominated countries into the world capitalist system and that this will continue as long as they remain tied to it, has been criticized from all quarters. Orthodox Marxists (not unlike neo-classical economists and modernization thinkers – see NEO-CLASSICAL ECONOMICS; MODERNIZATION THEORY) are of the view that it is the very lack, or insufficient penetration, of capitalist development in LDCs and not its presence -- which creates and perpetuates underdevelopment. Less economic-minded critics argue that it is the internal class structure of the dependent countries which impedes or conspires against the development of the productive forces, by failing to provide sufficient incentives – such as adequate levels of profitability – for capital (including foreign) investment. Thus underdevelopment and its continuance is not so much due to the appropriation of surplus from the LDCs by the DCs, but rather due to economic, social and political factors within LDCs which limit productive investment and the creation of wealth.

Dependency theorists have also been charged with economic reductionism for circumscribing the social, political and ideological factors to the economic level in society, and for contending that the country's social and political structure is determined by, or can be derived from, its economy. Dependency studies are seen as failing to examine, or as insufficiently examining, the social relations of production. Without an analysis of the social

relations of production there are no classes, no CLASS STRUGGLE and consequently no revolution. Others, in turn, criticize the dependency view that the national bourgeoisie no longer exists as an active social force and that it has become a lumpenbourgeoisie which is incapable of national accumulation as it squanders its resources in excessive consumerism.

Some critics regard this deficient class analysis of dependency authors as deriving from the location of dependency in the sphere of circulation, instead of in the sphere of production. By focusing on market and exchange relations, such a circulationist position neglects the analysis of social relations of production and consequently the configuration of classes and their characteristics. Another implication of this circulationist position is that it leads to the stagnationist thesis of some dependency authors, to their inability to focus on the improvement of the productive forces as the key to development and a failure to see the benefits of foreign investment. Again, it is important to differentiate between dependency writers. Dos Santos, for one, does not adopt a circulationist position. On the contrary, he categorically argues that underdevelopment and dependence cannot be explained through the mechanisms of exchange. Meanwhile Frank's dependency analysis is exposed to such a criticism.

The concept of dependence has also been criticized for implying the possibility of autonomous development or delinking. The LDCs' perceived lack of autonomy has indeed been defined by many dependency authors as the chief cause of underdevelopment and dependence. Furthermore, the Marxist dependency perspective has been attacked for its idealist and utopian conception of SOCIALISM and for believing in capitalism's collapse. This arises out of the assumed non-viability of dependent capitalism, which thereby sees socialism by default as the only alternative for achieving 'genuine' development. Critics argue that an adequate analysis of the prospects for socialism requires an understanding of the contradictions of capitalism, of the class struggle in specific social formations, of the identification

of revolutionary forces and of the formulation of the strategy and tactics for achieving power.

Last, but not least, the theoretical status of the notion of dependency has been queried for a variety of reasons. Given the variety of views on dependency, some prefer to speak of a dependency 'school', 'paradigm', 'approach' or 'perspective', rather than of a 'theory'. Cardoso himself suggested that it would be more fruitful to undertake studies of 'concrete situations of dependency' rather than constructing a formal theory. Some orthodox Marxists dismiss dependency theory altogether, replacing it with the theory of imperialism. They regard the Marxist laws of capitalism as being applicable to all capitalist modes of production and thus a separate theory of dependency is seen as superfluous. According to this view, there is no qualitative difference between the laws of development of advanced and of backward capitalist countries. In denying that any specific laws are operative in dependent countries, such critics challenge the very core of the dependency paradigm. In turn, such orthodox critics have been indicted for their sectarianism and dogmatism.

Assessment

A number of refinements, modifications and developments to the dependency framework have been proposed. Those who argue that the dependency perspective lacks a class analysis, propose a class analysis; those who sustain arguments that it marginalizes the political, advocate that this should be brought into focus; those who criticize it for its lax use of Marxist concepts, suggest that these should be applied more rigorously; those who charge dependency with having an excessive focus on the nation-state, argue that a world-system approach is more appropriate. Indeed several dependency thinkers have embraced world-system theory.

Any assessment of dependency analysis is complicated by the fact that no systematic and coherent theory of dependency has emerged. There is no doubt that dependency analysis

gave an enormous boost to the social sciences and development theory by stimulating a wealth of theoretical reflections and empirical research on the LDCs and their relationship to the world economy, particularly to the DCs. It has even influenced LIBERATION THEOLOGY. Many of the strengths and weaknesses of dependency analysis arise from the enormous scale of the enterprise. Dependency thinkers had the vision and audacity to create a new paradigm. They might not have succeeded, given that the interdisciplinary, historical, holistic and multiple character of dependency analysis is fraught with pitfalls which make the creation of such a paradigm perhaps an impossible task.

A valuable insight provided by dependency theory is that the dynamics of dependent countries have to be examined in relation to the dynamics of the dominant countries. Thus, internal and external relations are not seen as separate elements (as in dualist modernization theory), but as forming a dialectical unity. Dependent and dominant countries have become increasingly interrelated since colonial times in a complex web of economic, social, political and cultural elements, which form a totality. But this interrelationship is seen as asymmetrical by dependency theorists, as it is dominated by the DCs (although LDCs also shape these linkages).

A serious weakness of dependency analysis is its overdetermination of the external and its underemphasis on the internal causes of underdevelopment, thereby failing to pay sufficient attention to the class contradictions and obstacles to development within countries. This fosters the illusion of an autonomist path of development in which the underdevelopment of Third World countries is finally conquered. But, whatever the deficiencies of dependency theory, it has certainly contributed towards an understanding of the relationships between the internal and external webs of domination and exploitation, though its emphasis was on the external as it sought to redress the balance by criticizing modernization theory's emphasis on the internal and

orthodox Marxism's benign view of imperialism as the pioneer of capitalism.

See also:

autonomous development; delinking; development of underdevelopment; imperialism; structuralism; world-systems theory

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CRISTÓBAL KAY

dependent development

Unlike many other contributors to DEPENDENCY THEORY, Fernando H. Cardoso does not regard DEPENDENCE as being contradictory to development. To indicate this, he coined the term 'associated dependent development', often shortened to 'dependent development'. Accordingly, Cardoso's position is contrary to that of ANDRE GUNDER FRANK, who argues that when the links of dependence are intensified, growth falters and underdevelopment is intensified, but when they are loosened, domestic growth and development is enhanced. Cardoso highlights the dynamism of the dependent development model, but he recognizes its high social and political costs, such as the establishment of authoritarian regimes (see AUTHORITARIAN STATES), worsening income distribution, increased POVERTY, repression and marginalization. Although the bureaucratic authoritarian state (see BUREAUCRATIC AUTHORITARIANISM) has ensured the viability of capitalist development, it has done so by strengthening the links of dependence and by separating CIVIL SOCIETY from the STATE. As

the local bourgeoisie is unable to create a capitalist path of autonomous development, it marries itself even more firmly to transnational capital and MULTINATIONAL CORPORATIONS (MNCs). The local bourgeoisie has thus come to embody the anti-nation, by controlling a state which excludes most of civil society from participation and which represents the interests of foreign capital.

The dependency relationship largely arises because LESS-DEVELOPED COUNTRIES (LDCs) lack a capital-goods sector. Thus, in order to complete their cycle of capital accumulation, they have to link themselves to the developed countries (DCs) whose industrial sector has the all-important capital-goods industry which produces the new technology embodied in machinery, tools and new production processes. This leads to technical progress and economic growth. Thus, the key to the dependence of DEVELOPING COUNTRIES, despite major industrialization since World War II, is their failure to develop their own TECHNOLOGY, forcing them to rely on the MNCs whose headquarters are located in the DCs.

Like other dependency theorists, Fernando Cardoso argues that the continuation of the industrialization process and its extension from the consumer-goods industries to the intermediate- and capital-goods industries requires increasing capital accumulation, access to the centre's technology, increased foreign exchange and the cooperation of transnational corporations. These requirements mean that government policy has to shift radically from the welfarism and redistributivist policies of the populist phase towards containing popular demands, compressing wages and other measures which further income concentration and give appropriate guarantees to foreign capital. In many Latin American countries, the introduction of this package of policies led to the breakdown of democratic governments and the emergence of authoritarian-corporatist regimes in which a militarized techno-bureaucracy occupied a central position. Under this new regime, social exclusion is enhanced and marginality accentuated. This allows some

authoritarian regimes to break out of the cul-de-sac which IMPORT SUBSTITUTION INDUSTRIALIZATION (ISI) had run into, and to overcome the problem of stagnation by restructuring the political system and redefining the links of dependence.

However, Cardoso does not mechanically derive the major historical phases of dependent societies from the 'logic of capital accumulation', as for him the history of capital accumulation is embedded in the history of class struggles and political movements. His analysis of MNCs lacks the ECONOMISM of some dependency thinkers, as he places it within the political context of both the centre and periphery countries. He thereby avoids subordinating the political to the logic of accumulation of MNCs and thus to external factors.

This less deterministic analysis of Cardoso leads him to argue that, as some centre countries have lost political power in the international sphere, the possibility arises for some peripheral countries to pursue marginally autonomist policies, despite the increasing economic power of transnational corporations. While there is room for some form of associated-dependent capitalist development in dependent countries, the possibility of a transition to socialism is, in his view, remote.

See also:

autonomous development; delinking; development of underdevelopment; marginality; semi-periphery

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CRISTÓBAL KAY

depressions

Capitalist economies have an intrinsic tendency to grow; their growth, however, is subject to cyclical fluctuations. The downturn phase of a cycle is called 'recession'. If the downturn is deep and at the same time prolonged, it is called 'depression'. For example, economists and historians would characterize the period right after the Napoleonic Wars (1815–48) as a depression. However, there are reliable data only for the depressions of 1873–96 and 1929–40. The main features of these periods include withholding of investment, rising unemployment, and falling prices and profits.

There is no formal demarcation line between a recession and a depression. Some economists would claim that a recession is converted to a depression when the unemployment rate exceeds 10 per cent of the labour force (Heilbroner, 1992). According to this criterion, clearly both 1873–96 and 1929–1940 can be characterized as depressions. By the same criterion, the post-1973 slowdown in economic

activity can also be characterized as a depression, since the unemployment statistics in many countries exceeded the 10 per cent critical level. If we, however, examine the level of economic activity, we observe that there has not been such a deep fall, simply the growth rate of GDP slowed down considerably compared to its pre-1973 pace. In addition, the entire post-1973 period is characterized as inflationary rather than deflationary.

These differences led some economists to a discussion of the so-called 'contained depression' that started in 1973 and the emergence of the WELFARE STATE which, with its policies, maintained the aggregate demand at a level high enough for the general price level to keep rising. In addition, the government did not let unemployment increase to proportions similar to those of the previous depressions. The cost was that the so-called 'cathartic effects' of depressions (such as the destruction of a large number of small firms and the substantial reduction in real wages) did not work themselves out and, therefore, profitability did not increase in any significant way.

There have been various explanations for the depressions, ranging from pure monetary forces to real forces. These explanations assume either that the system is essentially healthy and governmental interference or even human error may lead to a depression (Friedman and Schwartz, 1963) or that the lack of appropriate government intervention is responsible for the depression, as was the case in the 1930s (Temin, 1990). There are, however, three other credible explanations that are based on the idea that the system is prone to depressions.

Joseph Schumpeter argued that the long periods of growth are caused by major technological innovations such as the development of the railways, which was mainly responsible for the growth in the United States and other countries during the 1850–70 period. The completion of the railway network and the concomitant slowdown in investment activity led to the depression of 1873–96. The second wave of growth starts at the end of the nineteenth century with electricity and home appliances, together with the petrol-driven

internal combustion engine that led to the development of the car industry. The period of completion for these innovations was some time at the end of 1920, after which the depression of the 1930s started.

Similarly, it could be argued that the post-war growth of the capitalist economies was caused by the mass production of cars (again), the jet plane and large investments in airports, hotels and so on (Heilbroner, 1992). However, at some point these investments were completed and that marked the onset of a new recession in the mid-1970s.

Another interpretation of depressions, emphasizing the role of institutions rather than of technology, was David Gordon's notion of the social structure of accumulation (SSA). By SSA, Gordon meant the set of institutions that dictate relations between entrepreneurs and workers in the organization of the labour process, which is mainly responsible for the levels of both productivity and profitability. The SSA is extended to include the relationship between business and government, and between governments internationally. Clearly, the SSA and the accords that it includes are crucial for the movement of both productivity and profitability. However, the accords do not last for ever: a period arrives in which they are in conflict with the existing stage of accumulation and new accords are needed. This period marks the onset of depression, which lasts as long as it takes for the formation of new accords and the new SSA, which will lead the economy to another long period of growth.

A Marxian explanation (Shaikh, 1992) holds that depressions are caused by the insatiable desire of capitalists to increase their profits, which leads them into two kinds of struggle: the first against workers in the labour process over productivity, the second against other capitalists over the expansion of their market share. In both struggles, capitalists succeed through the introduction of fixed capital, which increases the productivity of labour and lowers the unit cost. Thus capitalists, by reducing the price of their product, expand their market share at the expense of their competitors.

However, the investments in fixed capital, on the one hand, reduce the unit cost of production and increase the profit margins and mass of profits for the remaining firms but, on the other hand, through the increase in fixed capital lead to a falling profit rate.

Many major economists (ADAM SMITH, DAVID RICARDO, JOHN MAYNARD KEYNES, JOSEPH SCHUMPETER) have argued that a capitalist economy is led into a depression (the famous 'stationary state') as a result of the FALLING RATE OF PROFIT (FRP). Only KARL MARX, however, has offered a precise mechanism that leads to depressions. More specifically, the fall in the rate of profit exerts a negative effect on the mass of real profits and, at the same time, a positive effect through the accumulation of capital. So long as the positive effect exceeds the negative, the mass of real profits increases, even at an increasing rate in a long wave-like pattern. Since new investment is a function of the rate of profit, it follows that a falling rate of profit at some point will necessarily slow down the rate of growth of new investment, thereby slowing down the rate of increase in the mass of real profits. As this tendency continues, there will be a point that the two (positive and negative) effects will cancel each other out and the change in the mass of profits becomes zero. This means that the investment of the previous period did not contribute at all to the increase in profits and thus capitalists have no interest in new investment (Shaikh, 1992). This is the point that Marx, in the third volume of *Capital* (1981 [1894]), calls the point of 'absolute overaccumulation of capital' and considers it to mark the onset of economic crisis. As a consequence, investment slows down and this leads to rising unemployment and to the phenomena associated with depressions. As more and more firms are led to bankruptcies and real wages fall, these – together with the creation of new institutions, new ways of management and TECHNOLOGICAL CHANGE – lead to a rising rate of profit and the re-establishment of the necessary conditions for another wave of capital accumulation.

deregulation

See also:

capitalist crisis; crisis, global economic; crisis of world capitalism; crisis theory; Great Depression; Kondratieff waves; long cycles

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LEFTERIS TSOULFIDIS

deregulation

'Deregulation' refers to the reduction or elimination of government regulations over industry. It is most often used to refer to the reduction of economic regulations, such as price and entry restrictions, but may also be used to refer to the reduction of social regulations, such as health and safety codes. Most advanced industrial countries have experienced a broad deregulation movement since the 1980s that has redefined government-industry relations. Scholars differ considerably in their analysis of the causes of this movement, the forces shaping distinctive national

approaches to deregulation, and the costs and benefits of deregulation policies.

Popular commentators tend to use the term 'deregulation' to refer to both the reduction of regulation and the promotion of competition, as if the two were necessarily associated – that is, they assume that less regulation necessarily means more competition. In the case of US airline deregulation, this is precisely what happened: the government reduced regulation and eliminated a major regulatory agency, and by doing so stimulated greater competition. But in many other cases, governments have actually strengthened regulation in order to promote competition. In TELECOMMUNICATIONS, for example, most governments have increased regulation in order to foster competition with the former monopoly service providers. Thus deregulation is often a misnomer for regulatory reforms which combine market LIBERALIZATION with 're-regulation' (meaning the reformulation of existing regulations or the creation of new ones).

As a political movement, deregulation began in the United States in the mid-1970s, then spread to the United Kingdom and Japan in the early 1980s, and to most industrialized countries by the late 1980s. This reversed a long post-war trend towards higher levels of government regulation. In explaining this trend, scholars point to a variety of factors, including TECHNOLOGICAL CHANGE, the GLOBALIZATION of markets, US leadership, INTERNATIONAL ORGANIZATIONS (IOs) and domestic politics.

Forces driving regulatory change

Those who stress the role of market forces in driving regulatory change often point to dynamic sectors, such as finance and telecommunications, where technological advances and the globalization of markets have directly undermined modes of regulation (see MODE OF REGULATION (MOR)). In telecommunications, for example, new microwave and satellite transmission technologies challenged regulatory systems that presupposed a land-based communications network; in finance, firms

circumvented national regulations by completing transactions through affiliates abroad. Moreover, the globalization of markets has allowed firms to engage in regulatory ARBITRAGE, moving their business or capital to the country with the most favourable regulations. So national authorities may engage in competitive deregulation in order to retain business and capital within their borders.

Others point to international politics as a critical force in the diffusion of deregulation policies. The US government pressured the Japanese government to liberalize financial markets in the early 1980s, because US officials believed that this would help US exports by strengthening the yen. And US pressure for reciprocal access to telecommunications markets encouraged Germany and other countries to deregulate. Since the late 1980s, the EUROPEAN UNION (EU) has been the primary force driving deregulation policies in Europe. The United States has also worked through the WORLD TRADE ORGANIZATION (WTO) and other international organizations in promoting worldwide regulatory reform.

Yet others focus more on domestic politics. With the transition to slower economic growth after the oil crisis in the early 1970s, national opinion leaders began to question established modes of government intervention, from Keynesian demand management (see KEYNESIAN ECONOMICS) to industrial policy. Governments found that growth in demand for their services began to outpace growth in their resources. They faced tough choices: limit spending, increase taxation or finance the gap between revenues and expenditures through debt. In this context, deregulation took on special appeal as a political strategy, because it offers the possibility of cutting government expenses or at least controlling their growth by reducing administrative costs. It offers a way to turn the necessity of reducing public services into a popular cause by employing a rhetoric of cutting waste and eliminating inefficiency. It promises to improve economic performance without increasing government expenditure. And it is linked to PRIVATIZATION – a policy

that actually produces revenue with no visible cost to the taxpayer.

The most prevalent school of thought on the politics of regulation (sometimes referred to as ‘the theory of regulation’ – see REGULATION THEORY) focuses on interest groups. George Stigler and others contend that regulators tend to be ‘captured’ by the industries they regulate: they favour well-organized producers over poorly organized consumers. Thus regulators perpetuate inefficient cost and entry regulations that protect producers. Deregulation poses a challenge to the theory of regulation in that it is supposed to benefit consumers, not producers. Sam Peltzman and others maintain that deregulation is consistent with the theory, because producer groups themselves have pushed for deregulation as the regulatory system has ceased to serve their interests and other groups in favour of regulation have become more powerful. In this view, one can interpret the domestic politics of deregulation as a battle between a coalition of groups in favour of maintaining regulation versus another coalition in favour of dismantling it, with the outcome depending on the balance of power between the two.

Distinct national approaches to deregulation

Domestic political factors not only help us to understand the forces propelling regulatory change, but also to explain why it has taken different forms in different countries. For example, the United Kingdom and the United States have gone much further in pushing through pro-competitive regulatory reforms than other advanced industrial countries, such as France, Germany or Japan. In trying to explain this difference, one could point to IDEOLOGY, interest groups or institutions. That is, UK and US leaders may have been more convinced than their counterparts abroad of the economic benefits of deregulation, more likely to argue that deregulation would enhance their nations’ COMPARATIVE ADVANTAGE as a location of business activity and less likely to fear that it would hurt domestic producers by

opening markets to foreign competitors. Alternatively, those interest groups favouring deregulation – such as institutional investors or groups of corporate telecommunications users – may have been more powerful in the United Kingdom and the United States than elsewhere, or the regulatory bureaucracy may have been less entrenched than in other countries, where bureaucrats successfully stalled the process of reform.

In the United States, Senator Edward Kennedy initiated a series of hearings on airline regulation in 1975. The movement then quickly spread to trucking, the railways, the environment and occupational safety. Academic criticism of the inefficiencies of regulation combined with political entrepreneurship to produce a new policy fashion. With the Airline Deregulation Act of 1978, the US government eliminated the Civil Aeronautics Board, eased restrictions on market entry, phased out controls over airfares and permitted carriers to select their own routes. It moved on to the trucking industry with the Motor Carrier Act of 1980, which eased controls over entry, prices and routing. In telecommunications, it launched an antitrust suit against AT&T in 1974, eventually leading to AT&T being broken up into a long-distance company and local operating companies in 1982. In finance, it liberalized brokerage commissions in 1975 and phased out controls on deposit INTEREST RATES in the 1980s. The US government has gone further than other countries in promoting competition and in decentralizing regulatory authority to independent agencies and the courts. US corporations have been especially aggressive in challenging existing regulatory regimes through innovation in the marketplace, appeals in court and lobbying in the political arena.

In the United Kingdom, Prime Minister Margaret Thatcher launched a bold programme of privatization and deregulation beginning in 1979. The failure of successive efforts to use government intervention to revitalize the economy in the 1960s and 1970s provided the opportunity for a decisive move away from intervention in the 1980s. Under the

Transport Act of 1980, the government eliminated price and entry controls for long-distance buses and established trial areas for deregulation in local bus services. With the British Telecommunications Act of 1981, the government permitted firms to apply for licences to enter any segment of the telecommunications market in competition with the monopoly carrier, *British Telecom (BT)*. It went on to privatize *BT* and to devise an elaborate new regulatory regime to promote competition with *BT*. In finance, the government brokered a deal leading to the 'Big Bang' of 1986, which eliminated fixed brokerage commissions and led to a fundamental restructuring of the City of London (see LONDON, CITY OF). In electricity, it broke up and privatized the monopoly service provider in 1990 and established a new regulatory agency to promote competition in the sector. And under the 1990 Broadcasting Act, it opened independent television and radio companies to competition and set up a new regime to auction licences and regulate competition. The Thatcher government aggressively employed regulation as a tool in promoting competition. Over the course of the 1980s, the UK government shifted from a relatively informal approach to regulation to a much more formal and legalistic system, and created a wide range of new independent regulatory agencies on the US model.

The Japanese government also adopted a wide range of regulatory reforms, beginning in the 1980s, but its approach diverged sharply from that of the United States or the United Kingdom. The Japanese government was extremely cautious in promoting competition or reducing or devolving regulatory authority. In Japan, the deregulation movement began with the Second Provisional Commission on Administrative Reform (also known as the 'Rincho'), which presented a report in 1982 recommending sweeping bureaucratic restructuring and deregulation. In practice, however, the Japanese reform programme was more successful with privatization than with the promotion of competition or the reduction of regulation. In telecommunications, the government opened valued-added services to compe-

tion in 1982, then privatized NTT and opened the telephone market to competition in 1985. In finance, it gradually liberalized deposit interest rates from 1985 through 1994 and began the process of lowering regulatory barriers between different segments of the financial industry (such as banking, brokerage and insurance) in 1992. In the 1990s, the Japanese government gradually accelerated its deregulation programme. Even so, Japanese regulatory authorities have managed competition even after 'deregulation' – controlling new entry and minimizing exit from the market. They have retained a discretionary regulatory style and they have resisted the devolution of regulatory responsibilities to independent agencies outside the central government ministries. Some have argued that the failure to deregulate more thoroughly contributed to the Japanese economy's weakness in the 1990s.

Legacy of deregulation

In trying to assess the impact of deregulation, analysts differ on three central questions. First, does deregulation imply a retreat of the STATE? Some argue that governments have virtually given up their ability to control firms and markets. Once they reduce their regulatory capacity and unleash markets, they are unable to reassert control. Others note, however, that governments have not actually decreased the level of regulation at all. They have reduced regulation in some areas, yet they have increased it in many others. The Japanese government has gone to painstaking effort to record changes in the number of government regulations, only to find that the number has increased, not decreased, during the period of its deregulation programme. The key issue is not the number of regulations, of course, but the effectiveness of competition and the capacity of the government to influence the behaviour of firms. Although we lack definitive data, the available evidence suggests that results vary considerably across countries and across sectors where deregulation has occurred.

Second, does the deregulation movement imply a CONVERGENCE among national eco-

nomic systems? The advanced industrial countries have converged in that they have all adopted deregulation policies of one sort or another during the period from the late 1970s through to the present. In the most dynamic and global sectors, the level of policy convergence can be striking. All major industrial countries have introduced competition in telecommunications, and all have removed or eased capital controls and deposit interest-rate regulations (see CAPITAL, CONTROLS ON). Yet, as noted above, they have developed very different types of new regulatory regimes. Some governments have formalized regulation more than others; some have relaxed their supervision over industry, whereas others have intensified this supervision. Ultimately, these differences in the mode of regulation continue to set the terms of market competition: they affect which companies enter the market, what services they offer, what investments they make and what strategies they pursue. In other words, the nationally specific interaction between government and industry continues to influence the nature of competition within a given market even after it has been formally deregulated.

Third, has deregulation delivered the economic benefits promised by its advocates? Here, most economists agree that the benefits of deregulation have exceeded its costs. It has promoted competition, leading to lower prices and more new products and services. Household consumers and businesses now enjoy a much greater variety of telecommunications equipment at lower prices, and investors and borrowers can choose from a wider menu of financial instruments, while forfeiting smaller margins to financial intermediaries. Critics, however, offer several warnings. Deregulation can be enormously disruptive, putting firms out of business and workers out of work. It can threaten communities, wiping out small stores or unprofitable train lines. And it can undermine safety or environmental protection.

See also:

capital, internationalization of; competition

derivatives

and government policy; competition, economic role of; disengagement; internationalization

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derivatives

A 'derivative' is a security whose value is based on (that is, 'derived' from) the value of an underlying index (such as the FTSE), an INTEREST RATE or an asset. 'Options' and 'futures' (see OPTIONS, FINANCIAL; FUTURES) are the most common forms of derivatives, but there are a variety of other derivative arrangements, including 'forward contracts' which are traded in FORWARD MARKETS. Derivatives may either be traded directly on a regulated exchange market or outside the exchanges in 'over-the-counter' (OTC) transactions. Exchange-traded derivatives in general offer greater liquidity than OTC contracts, which are specifically designed to meet the needs of buyers and sellers.

When entering into a derivative agreement, the parties to that agreement will specify the means and rate of repayment in detail. Thus, for example, the payment may be made in currency, in securities or in a physical commodity such as gold. Equally, the actual amount of the repayment may be bound to the progress of interest rates or foreign currency values. Derivative products may also contain so-called 'leveraging'. The latter acts to multiply – either favourably or unfavourably – the impact on the total repayment obligations of the parties to the derivative instrument.

In general, investors use derivatives as a way of managing RISK, in that derivatives can serve to diminish the risk inherent in the fluctuations of foreign exchange rates (see EXCHANGE RATE), interest rates and market prices. For example, if a British company expects payment for a delivery of goods in US dollars, then it may enter into a derivative contract with another agent in order to reduce the risk that the exchange rate between US dollars and pounds sterling will be unfavourable to it at the time that the bill is due and paid. Using a derivative means that the other agent is obliged to pay the British company the amount outstanding at the exchange rate that prevailed at the time that the derivative contract was executed. By using the derivative product, the company has shifted the risk of exchange-rate movement to another agent. Furthermore, a derivative can offset the volatility of existing investments. For example, by using options (a form of derivative that is a fixed contract that gives the buyer the right, but not the obligation, to buy or sell an asset at a specified time at a preset price), it is possible to guarantee the price of a stock for a specified period, 'HEDGING' against a possible price decline. Derivatives can also allow an investor to take maximum advantage of a market forecast. However, although derivatives are used as a way of managing the risks of other investments, they also have risks of their own. These include the sensitivity of prices to market conditions, such as fluctuations in interest rates or currency exchange rates.

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desertification

Desertification is the process by which formerly productive land deteriorates to a desert-like condition, through climatic change and/or human interference with ecosystems. Concern about the apparent rapidity of the process has been growing since the 1970s, especially with regard to the southern fringe of the Sahara desert.

Study of the interaction of human interference with climate change, itself believed to be linked to that interference, focused on the combination of population pressure on marginal lands and the penetration of sustainable agricultural practices by capitalist imperatives: over-cropping; deforestation; and other land-use changes undertaken to promote (short-term) productivity gains that stimulated soil degradation.

Means of tackling desertification have been explored and promoted by the Nairobi-based UNITED NATIONS ENVIRONMENTAL PROGRAMME (UNEP). Recent analyses have suggested that earlier forecasts of the rate and extent of desertification were based on somewhat dubious evidence, but led to the formulation of a 'desertification myth' that up to one-third of the earth's productive soils were under threat (Thomas and Middleton, 1994). That myth was sustained by the politicians and bureaucrats involved in UNEP's work, however, and is only now being countered by more reliable scientific evidence. There is no doubt that desertification is a current threat, just as much as it was considered to be when associated with ecosystem destruction in the

past, but for a time it was a 'concept out of hand'.

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RON JOHNSTON

deskilling

The term 'deskilling' has been used to describe the changes that have taken place in the content and organization of work, particularly in industrial manufacture, as a result of transformations in technology and management strategy. Mechanization, particularly assembly-line production, allowed the possibility of extreme specialization, with workers completing simpler, less-skilled tasks, so that jobs became increasingly fragmented and routinized over the long term. The fragmentation of work processes, together with 'scientific management' methods which stipulate 'one best way' of organizing and executing tasks, intensified the separation of mental and manual labour, and concentrated control over work methods and the pace of work in the hands of managers. The erosion of craft skills and controls resulted in a growth in the numbers of semi-skilled and unskilled workers, who may be more easily replaced and so find it harder to exercise occupational control; this in turn may lead to wage rates becoming depressed.

White-collar workers are also seen to have been affected by the long-term trend for jobs to

détente

be stripped of their intrinsic content, as their work also became increasingly routinized and centrally controlled. Increased automation and new technologies accelerated the rate of change in both manual and white-collar work, and have been seen to decrease the need for labour and to concentrate control into even fewer hands.

Critics of the deskilling thesis consider the proportion of skilled craft workers in the nineteenth century to have been overestimated, leading to an exaggeration of the extent of deskilling. Equally, the attribution of the level of skill involved in a task is seen as arbitrary, so that it is difficult to determine the extent and nature of change. Feminist writers, in particular, have argued that the label 'unskilled' has often been attached to women's work as a legitimization of lower rates of pay. Additionally, the introduction of new types of production may lead to reskilling rather than deskilling, with the use of robots and other technologies freeing workers from routine work and allowing them to develop technical skills of a higher level.

The evidence relating to the effects of technological change is mixed and much depends on the actions and philosophies of management. In some areas, the introduction of new technologies has meant a loss of semi-skilled jobs with the fewer, technologically more challenging, jobs being taken over by newly trained workers. In other areas, increased automation has meant that skilled maintenance engineers are needed, but skilled process-workers have been displaced. Overall, some skills have disappeared and others have emerged: there has been a pattern of both deskilling and reskilling, with changes in the content and organization of work depending on management decisions, as well as on the available technology.

See also:

alienation; capitalism; division of labour; skills

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détente

'Détente' usually refers to the relaxation of tensions between the United States and the Soviet Union during the COLD WAR, but also applies to reduced tensions between countries in conflict during other historical periods. The Cold War détente is sometimes dated from the advent of President Richard Nixon in 1969 to the Soviet invasion of Afghanistan in 1979. The period was characterized by extensive bilateral diplomacy and numerous arms control treaties between the United States and the Soviet Union, most notably the 1972 Anti-Ballistic Missile (ABM) Treaty and the first and second Strategic Arms Limitation Talks (SALT I and SALT II) agreements.

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determinism

From a deterministic viewpoint, everything that exists is the result of its antecedent causes and could not be any other way. Theories of determinism are about as old as philosophy. In Greek philosophy, the idea of determinism was closely related to the concept of god. A universe where everything is causally linked and bound to eternal change requires an

eternal first and unchangeable cause of motion, which is god. Aristotle proved the necessary existence of god as the first cause of eternal changes in the universe.

In the Middle Ages in Europe, as well as in the Oriental World, Aristotle's god (who is, among other things, perfectly good, omniscient and omnipotent) formed the basis for the theological determinism of Christianity and Islam. From the seventeenth century onwards, with the emergence of modern science, philosophers have repeatedly used different physical theories as their guide to explaining the rules by which determinism can be identified.

The notion of explaining historical trends in terms of the operation of natural laws brings us to the Marxist conception of necessity in history. The idea that, by natural science, the present could be understood and the future predicted is a basic claim of the Marxist theory of dialectical materialism, developed by Engels in his main books *Anti-Dühring* and *Dialectics of Nature*. According to the latter, nature and history are ruled by the same dialectical laws, or by their own objective law. Thus, theory is a 'natural philosophy' that, by means of natural science, at the same time explains nature and social history.

What are the implications of dialectical materialism for social theory and social change? Economic determinism, from this viewpoint, takes the form of laws by which major contradictions are identified within the processes of production, exchange and distribution, and are used to explain historical change in society. Society is understood dualistically, as being divided into base and superstructure, whereby the economic base determines the existence and forms of the state and social consciousness: the superstructure.

Dialectical materialism was an essential component of the first Marxist generation and very powerful in the Second International (1889–1914). George Plekhanov, called the 'Father of Russian Marxism', made a great contribution to the spread of the mechanical interpretation of history and economic reductionism.

In the 1960s, Althusserian STRUCTURALISM emerged as an oppositional approach to Russian Marxism. Althusser introduced the concept of the structural whole that has a causal priority over the economy, policy and ideology. A social formation has no centre, but is made up of a hierarchy of practices or structures, some of which are economically independent and act autonomously. The economy only determines, in the last instance, which constituent of this hierarchy becomes dominant in a certain historical situation. According to this view, human beings or agency are not the authors of this process but are themselves subject to it.

In the discipline of international political economy (IPE), the structuralist or determinist approach has been set into the international terrain by WORLD-SYSTEMS THEORY. According to world-systems theory, the modern world consists of only one capitalist world economic system, divided into core, semi-periphery and periphery. States are determined by their position in the world system.

With his concept of historical structures, Cox has developed a methodology for the study of historical change in IPE to overcome the dualistic distinction between agency/structure and provide an ontological and epistemological foundation for a non-deterministic yet structurally grounded explanation of change. Historical structures are a particular configuration of ideas, institutions and material forces. They are an organic totality of both the subjective and objective: agency is conditioned by prevailing structures. But structures are the product of history. They are the cumulative result of how people collectively respond to the conditions of their existence – that is, structures are shaped over time by agency (Cox, 1987). This means a rejection of structural determinism and a confirmation that the social world is formed by collective human action.

See also:

Marx, Karl Heinrich; Marxism Leninism

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MEHDI PARVIZI AMINEH

determinism, economic

DETERMINISM is a philosophical thesis which contends that every event is the inevitable result of antecedent causes. Economic determinism is a subcategory of determinism, whose origins are usually attributed to KARL MARX. Marx's conception of history is known by various names: HISTORICAL MATERIALISM, the material conception of history and the economic interpretation of history or economic determinism. Briefly stated, economic determinism in Marx rests on the notion that economic interests and economic forces are the foundations of all social and political conflicts. Marx first developed his concept of economic determinism in a much quoted passage from the preface to *A Contribution to the Critique of Political Economy* (published in 1859):

In the social production which men carry on they enter into definite relations that are indispensable and independent of their will; these relations of production correspond to a definite stage of development of their material powers of production. The sum total of these relations of production constitutes the economic structure of society – the real foundation on which rise legal and political superstructures and to which corre-

spond definite forms of social consciousness ... It is not the consciousness of men that determines their existence, but, on the contrary, their social existence determines their consciousness.

(Marx, 1958: Preface)

This could be read as a form of economic determinism that leaves virtually no role for politics, ideas or human agents. In fact, the principal opposition to determinism comes from those who believe that human beings are more than merely natural creatures and that they are possessed of free will. The form of economic determinism actually incorporated into Marx's theory of history, however, was not as strict as this quotation suggests. The proposition that every event has a cause was relaxed somewhat by Marx to the idea that every event is predictable from its economic antecedents. This is the approach taken by Marx (with Engels in the *Communist Manifesto*, published in 1848) that 'the history of all hitherto existing society is the history of CLASS STRUGGLES'. Such struggles occur in societies formed by different MODES OF PRODUCTION – for example, slavery, FEUDALISM and CAPITALISM. In each of these kinds of societies, a minority of people own or control (or both own and control) the means of production: land, tools, raw materials, machines, labour and money. This minority constitutes the ruling class. The vast majority of people own and control very little or nothing. They mainly own their own capacity to work and they create the surplus that is largely appropriated by the ruling class. Other 'intermediate' classes exist in any society, but the 'basic' classes are the ruling class, on one hand, and the 'direct producers', on the other.

The main human agency of revolution is the working class (see CLASS, WORKING). One of Marx's most deeply held beliefs, inscribed in the rules of the First International of Working Men (formed in London in 1864), which he dominated, was that 'the emancipation of the working classes must be achieved by the working classes themselves'. For it is the

working class that experiences most keenly the adverse effects of the 'contradictions' by which capitalism is irremediably plagued; it is therefore the working class that will come to acquire, in the course of many struggles and setbacks, a revolutionary consciousness. Marx did not discount the possibility that the working class might, in some very exceptional cases, be able to dispose of capitalism peacefully. But he believed that, in general, it would only be able to overthrow capitalism by revolution.

This view of the historical process came to be known as 'historical materialism' or 'economic determinism'. At its core, historical materialism rests on a belief in the primacy of the external world, in which the economic structure constitutes the 'real basis' of society. On this basis arises a 'legal and political SUPERSTRUCTURE', as well as 'definite forms of social consciousness'. As noted above, Marx was not a strict determinist and Engels was correct to say that the materialist conception of history was only intended to assert that 'the ultimately determining element in history is the production and reproduction of real life'; therefore, while 'the economic situation is the basis', still 'the various elements of the superstructure ... also exercise their influence upon the course of the historical struggles and in many cases preponderate in determining their form' (Marx and Engels, 1991: 103).

In sum, the key forces of economic determinism are the forces of production, RELATIONS OF PRODUCTION, economic structure and superstructure. There is a vast literature dealing with these concepts and the way they are supposedly interrelated in the *modus operandi* of the theory. The motor of change is generally located in the forces of production; as they develop (the possibility of their regressing is never entertained), they clash with the relations of production; the resulting misfit of forces and relations induces a revolutionizing of the base; the new base calls for and acquires a new superstructure. This completes the transformation of the old mode of production into a new one.

Economic determinism has remained a major source of controversy since Marx's time. Much of the debate centres on the problems of

determinism versus human autonomy, the relation of active human agents to the external world and so on. The decisions resulting from human will are not caused by natural conditions, and yet they are able to influence the course of natural events. This belief is based on the feeling of freedom to choose one course rather than another.

One tendency has been to interpret the previous paragraph's schema in a very mechanical way. Specifically, the concepts (forces, relations, base, superstructure) are often treated as separate and interacting entities like the parts of a machine, each subject to analysis independently of the others and all being meshed together according to an invariant design. Indeed, it is precisely this kind of mechanistic interpretation that has come to be widely accepted as the essence of Marxism not only by its critics but by many Marxists themselves.

One version, held mainly by non-Marxists, is that Marx and contemporary Marxists believe:

- 1 in economic reductionism, that everything is determined by the economic factor;
- 2 in a teleological theory of history, that humans are puppets and that everything that happens is predetermined by 'historical forces' or 'technology' or whatever, and
- 3 that there are only two classes, capital and labour; they are in continuous conflict, and every member of the working class has the exact same interests and the same rational response, while every member of the capitalist class has the opposite interests and reacts rationally and logically against the working class.

(Sherman, 1998)

According to this view, Soviet Marxist thinking was characterized by economic reductionism, inevitable laws of history (for example, the predetermined succession of modes of production: slavery, feudalism, capitalism, socialism, communism) and extreme methodological collectivism (classes dominating political dynamics, with little attention paid to individual motivations).

detrterritorialization

Howard Sherman, the leading contemporary scholar writing on economic determinism, contends that in actuality contemporary Marxists have a much more sophisticated framework. In his words (1998):

First, we reject the single factor reductionism of economic determinism or of psychological individualism. Instead, we take a holistic view of the whole society, sometimes called a relational view because it does not allow for single factors, but only for relations and processes.

Second, we reject any teleological view of history. Instead, we have an evolutionary view based on endogenous change due to changing human behavior. Human beings make their own history, but they obviously make it under given circumstances at any given time. Any reform or revolution is made by human beings, not by extra-human forces.

Third, contemporary Marxists certainly use a class analysis, but not a simplistic one. There are usually multiple classes in any real social formation. There are shifting coalitions, and, except in a socioeconomic revolution, the majority of the exploited and oppressed classes support the status quo or take it for granted in a resigned sort of way.

(Sherman, 1998: 109)

In sum, while still arguing that the institutional evolution of economies and societies is subject to systematic analysis and prediction, contemporary Marxism rejects iron laws of development in favour of analysis of the outcomes of people, classes and other collective groupings acting on and being changed by their historically given circumstances. All individual/collective, action/structure dichotomies are false in so far as 'people making history under circumstances which they do not choose' (to paraphrase Marx) is precisely the way that society evolves. Hence class struggles and other social conflicts still play a crucial role in the new Marxism.

See also:

Marxism Leninism

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ROBERT LOONEY

detrterritorialization

'Deterritorialization' refers to the erosion of the territorial NATION-STATE as the dominant spatial and analytic unit of international political economy (IPE). For much of the twentieth century, territorial nation-states managed and directed their national economies, either through centralized planning or federal monetary and labour policies. Beginning in the 1970s, scholars began to question this territorial state-centric understanding of IPE. Much of this early discussion of deterritorialization focused on the rise of MULTINATIONAL CORPORATIONS (MNCs). Unlike nation-states, MNCs were not tied to any particular territory but could migrate to the most favourable sites of production around the world. This erosion of territorial boundaries and the rise of a globalized economy (see GLOBALIZATION) has led to what Kenichi Ohmae (1990) termed a 'borderless world'.

A number of factors suggest we are living in a deterritorialized or borderless world. First, the traditional instruments of federal bankers – INTEREST RATES and money supply – are becoming obsolete, as money now travels around the world unhindered by territorial state regulations. Second, as more flexible

forms of production make manufacturing more mobile, companies can more easily relocate to communities or states that offer the fewest regulations and the highest rates of profit. The economic interests of firms are increasingly detached from the interests of a territorial national economy. Third, technological developments in communications and transportation have accelerated the speed at which people and information travel, making them less tied to territorial spaces. Fourth, the decline in the power of national governments has spurred efforts to create transnational or global governance, from transnational social movements to the creation of a global economic regulatory body (see GOVERNANCE, GLOBAL). Fifth, even the most immobile economic resource – labour – is becoming increasingly detached from territorial restraints, as global migrations of labourers become a common symbol of the new global economy.

Some critics argue that the progress of deterritorialization has been overstated. John Agnew and Stuart Corbridge (1995) assert that although the changing international political economy can no longer be understood in terms of a fixed and static concept of a territorial nation-state, territory still plays an important role in IPE. A bipolar world of autonomous nation-states has been replaced by a polycentric world in which POWER emanates from transnational actors as well as territorial nation-states. Moreover, the rise of ethnic and nationalist separatist movements since the end of the COLD WAR also suggests that descriptions of the world as 'borderless' may be premature.

See also:

territoriality; world economy

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Ohmae, K. (1990) *The Borderless World: Power and Strategy in the Interlinked World Economy*, New York: Harper Business. A management consultant argues that the interlinked economies of Europe, Japan and the United States, with their free flow of information, money, goods and services, has created a borderless world.

NICOLE LINDSTROM

devaluation, currency

A devaluation is a change in an EXCHANGE RATE which reduces the value of one currency in relation to others. Although devaluations always involve a depreciation in a currency's value, the term devaluation is usually limited to depreciations which occur under pegged or FIXED EXCHANGE RATE regimes which a government has previously committed itself to maintaining. For example, under the BRETTON WOODS SYSTEM of fixed exchange rates, countries agreed to the stabilization of their exchange rates within bands of plus or minus 1 per cent (widened to 2.25 per cent in December 1971) around the parity or par value of the exchange rate. This enabled a currency to depreciate by a maximum of 2 per cent without a formal devaluation. Changes in the par rate itself, however, could be made only in the face of serious balance-of-payment problems. A currency devaluation is generally considered by a government to be a last resort, taken in order to correct a balance-of-payments deficit. A devaluation does this by lowering the price of exports in terms of foreign currencies and raising the price of imports in the domestic market. The immediate impact of this is an improvement in a country's international competitiveness, other things being equal. In import terms, resources will be drawn into domestic industries whose goods

developing countries

are now competing more effectively with those of foreign industries. In export terms, resources will be drawn into export industries, which can now compete more effectively in foreign markets. In the long run, however, a devaluation does not necessarily succeed in its intention: in most cases, it is followed by adjustments through the rest of the economy, as a result of which the effects of the initial exchange rate changes are neutralized.

Although FLEXIBLE EXCHANGE RATES were adopted by a majority of industrial countries in the 1970s, the issue of devaluation is still an important one – particularly for those countries whose currencies remain pegged to others in a variety of formal and informal currency arrangements. This was a key proximate cause of the Asian financial crisis that began in Thailand in mid-1997 (see ASIAN CRISIS). In addition, the analysis of currency devaluation, more generally, addresses the issue of how an economy responds to changes in exchange rates. In particular, the establishment of the EXCHANGE RATE MECHANISM (ERM) of the EUROPEAN MONETARY SYSTEM (EMS) in 1979, ushered in a new period of exchange rate fixity between the major European currencies. Under this regime, up until the early 1990s, the bilateral exchange rates of many European currencies were fixed within 2.25 or 6 per cent bands (depending on the currency). With crises in the ERM in 1992 and 1993, however, these bands were widened to 15 per cent, with Italy and the United Kingdom exiting the ERM completely. The latter demonstrated the political cost of a currency devaluation. Indeed, some devaluations may be regarded as turning-points in a country's economic history, as witnessed by the devaluation of the French franc in 1969.

See also:

balance of payments; currency depreciation

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ALISON M.S. WATSON

developing countries

The main criterion used to classify economies and to make broad distinctions between different stages of economic development is GROSS NATIONAL PRODUCT (GNP) per capita. Countries can be classified by their state of DEVELOPMENT using a strict numerical ranking, but they are more usually classified (often with a certain degree of arbitrariness) into groups.

The WORLD BANK (1999), for example, uses the following classification: 'low-income economies' are defined as having a per capita income of US\$785 or less; 'middle-income economies' have a per capita income between US\$786 and US\$9,655, and a further division at GNP per capita US\$3,125 is made between 'lower middle-income economies' and 'upper middle-income economies'. According to this classification, in 1997 low-income economies accounted for approximately 2 billion people at an average per capita income of US\$350; middle-income economies accounted for 2.9 billion people at an average per capita income of US\$1,890. Although the World Bank does not explicitly use the term 'developing countries' to refer to low- and middle-income economies, they constitute our 'developing economy' category.

Other classifications can be used to group poor countries. Countries that produce and export oil will typically be kept separate from those dependent on imports; countries with a high proportion of industrial exports may well be separated from those wholly dependent on primary-product exports. Classifications based

on region will often highlight important differences between geographically separate developing countries.

Developing countries, by definition, share the common condition of POVERTY. But in all other respects they display great heterogeneity with respect to history, geography, size, population density, socioeconomic indicators, the structure of production and trade, income distribution and culture. It is difficult to see what Mozambique (estimated in 1997 to be the poorest country in the world, with a per capita income of US\$90) or Ethiopia (with a per capita income of US\$110) have in common with Argentina (per capita income of US\$8,570) or Malaysia (per capita income of US\$4,680).

The limitations of GNP per capita as an index of economic welfare or development are well known and many attempts have been made to develop composite indices. The best known of these is the Human Development Index (HDI) produced by the UNITED NATIONS DEVELOPMENT PROGRAMME (UNDP).

Rankings according to GNP per capita and HDI often differ quite substantially. For example, Saudi Arabia and Oman have HDI rankings well below their GNP per capita rankings. On the other hand, Tanzania and Vietnam have HDI rankings significantly above their GNP per capita rankings, indicating that these economies have emphasized the provision of healthcare and educational facilities as part of their development effort. Clearly using the HDI as a measure of development and as a way of classifying developing countries gives us a different perspective on the developing world and the development process itself.

Notwithstanding the above, the attempt to categorize poor countries has led to a plethora of often confusing and sometimes meaningless terminology. Poor countries have variously been referred to as 'backward', 'underdeveloped', 'less developed' and 'developing', the 'THIRD WORLD', 'the SOUTH' and the 'periphery'. All these terms raise as many – or indeed more – questions than they answer. They either presuppose that poor countries lack some

combination of factors or attributes that prevents them from becoming 'developed' or they imply that there is some progress towards 'development', although it is not always clear what 'development' means in this context. Alternatively, poor countries are seen as marginal within the global economy, with the implication being that they are in some sense apart from or not integrated into that economy, and/or that their subordinate position puts a constraint on or otherwise prevents or distorts their development prospects.

However, whatever the qualifications that we may wish to make with respect to the terminology that we choose, in order to try and say sensible and interesting things about the world, we are forced to use essentially arbitrary categorizations and use less-than-perfect terminology. For these reasons, 'developing countries' is probably currently the most commonly used term to describe poor countries.

We noted above that developing countries share their poverty but perhaps little else. Nevertheless, we must search for a 'unity in diversity' (South Commission, 1990) if the identification and study of developing countries is to be credible. Various efforts have been made to draw up lists of common characteristics and the following is an eclectic compilation:

- 1 The great majority of developing countries share a common historical background of COLONIALISM and at independence inherited particular structures of production and trade that defined their economic 'backwardness' *vis-à-vis* the developed capitalist economies.
- 2 The structure of production and employment was dominated by the agricultural sector, a large proportion of the output of which was classified as subsistence (non-marketed) output. Even in 1997, the average share of the agricultural sector in GDP was 31 per cent in low-income economies, as compared to 10 per cent in upper-middle-income economies (and less than 3 per cent in high-income developed capitalist economies).
- 3 Exports of low-income economies were

developing countries

dominated by primary products (food and raw materials), often with a high commodity concentration ratio and serving a limited number of markets (see COMMODITIES). Imports consisted largely of manufactured goods (consumer goods, fuels and raw materials).

- 4 Initial attempts at industrialization were largely based on the strategy of IMPORT SUBSTITUTING INDUSTRIALIZATION (ISI) (the domestic production of a commodity previously imported). Imports of INTERMEDIATE, INVESTMENT and capital goods now become more significant; FOREIGN DIRECT INVESTMENT (FDI) via the MULTINATIONAL CORPORATION (MNC) becomes increasingly important for many economies in a wide range of consumer goods industries; and dependence on foreign technologies increases.
- 5 Developing countries typically have high rates of POPULATION GROWTH. Between 1990–7, the average annual rate of population growth for the low-income economies was 2.1 per cent, as compared to 1.3 per cent for the middle-income economies (and 0.7 per cent for high-income economies). Developing countries have high dependency ratios and high urban population growth rates, in large part the result of massive rural-to-urban migration.
- 6 Developing countries are characterized by high levels of inequality in the distribution of income and wealth. The Latin American economies are the most unequal, with the top 10 per cent of income recipients accounting for over 40 per cent of total income (48 per cent in the case of Brazil in 1995; 46 per cent in the case of Chile in 1994), as compared to 24.7 per cent in the case of the United Kingdom (1986). It is clear that the distribution of income and assets has a profound influence on the nature and characteristics of the development process and is, in turn, in part determined by that process.
- 7 Many would argue that, at a very general level, there exists a condition of cultural, psychological, social and political DEPENDENCE

and subordination. The lifestyles of the middle- and upper-income groups in poor countries, in particular, show a marked convergence towards a global 'norm'.

This list is not exhaustive and by itself it does not explain why some countries have been more successful in their attempts at development than others. Likewise, it would be wrong to see developing countries as somehow unchanging or static. Complex processes of socioeconomic and socio-political change are all-pervasive. The emergence of the NEWLY INDUSTRIALIZED COUNTRIES (NICs), continued urbanization, the impact of new technologies and the process of GLOBALIZATION are accelerating change in developing countries. Such changes are not necessarily consistent with a normative concept of 'development'. The development process in developing countries in reality may well disadvantage, if not positively harm, large numbers of people, impose huge environmental costs, lead to massive over-urbanization, depend on the EXPLOITATION of female and child labour, and, in general, bear very little resemblance to liberal notions of 'progress'. We need a concept of development itself that can encompass both the progressive and the destructive tendencies of the development process.

Developing countries do not represent some natural or traditional economy or society. They were created by specific global economic forces. Large areas of the world were incorporated into the expanding world economy through the outward thrust of the rapidly growing economies of Western Europe from the sixteenth century onwards. This appreciation of the historical context is essential for an understanding of the emergence of developing countries. But too often we only see the past and get trapped in a 'Third Worldist' perspective, which sees the problems of development as located in the conflict between rich and poor countries. In reality, the issue is more complex and we must recognize the huge inequalities of income within developing countries, the emergence of new groups or classes with interests often very different from the normative defini-

tion of development, and the conflicts between classes or classes-in-forma-tion in those countries, which many would argue are what really determine the outcomes of the development process.

See also:

dependency theory; Fourth World; Third World

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FREDERICK NIXSON

development

Development cannot be defined in any simple way. It is a political and cultural term, and therefore heavily disputed. A product of Western thought, culture and political interests, it has often been used as though it were technical, neutral and merely descriptive. In this sense, it is used to describe the goals of higher levels of life, improved efficiency of production and distribution, increased social and economic scale and continuing growth, and, in some respects of 'Westernization', repetition of the supposed direction and narrative of Western history to become 'modern'. Recently, when used in this way, efforts have been made to put issues of distribution to the fore. This is seen in the use of the Human Development Index and of human rights as part of the approach advocated by the UNITED NATIONS DEVELOPMENT PROGRAMME (UNDP). In contrast, many commentators

from both the North and the South, and from within the environmental movement, now question it as a goal. This is particularly true of those writing from a post-modern perspective. The result is a paradox. Many governments, intellectuals and ordinary people in the South still aspire to these goals, while some intellectuals in the North and to some extent in the South and from the environmental movements would discard it as a desirable or possible aim. Some would now reject development as a goal, while others would continue to seek it for the future it promises.

Since the establishment of the BRETTON WOODS SYSTEM, development has referred to the process whereby poor countries or communities are able (from within their own resources) or enabled (by others) to improve their situation economically, socially and culturally. Development has often been presented as though it were a technical process based on scientific findings and agreed knowledge. This is not the case and is a position which obscures the political issues, although once the politics have been settled, such techniques may well be appropriate and necessary.

We should note that the verb 'to develop' can have both a subject – those who do the developing – and an object – those who are developed. This points to its political nature: some have the power to develop and others do not. Development is and always has been a highly, even exclusively, political process. It is an activity where people organize and use resources (material, social, cultural or ideological) to achieve a goal defined by or for them as 'development'. As a political endeavour, it is part of the language of POWER. The word is thus both political and ideological (see IDEOLOGY), and contains at its core a notion that there is a direction, a goal, in human affairs. This includes some or all of the following: improvement, betterment, growth, increase of scale, emancipation and, perhaps above all, a concern with the problem of POVERTY. It may include the kind of ideas implied by the slogan of the French revolution: liberty, equality and fraternity, or the later Soviet revolution: 'from each according to their abilities, to each

according to their needs'. It may mean that communities and individuals should be enabled or enable themselves to take control of their own lives. Or it may be used to refer to market-oriented reforms intended to facilitate efficient production and allocation of goods and services within and between human societies through market institutions. The idea can and has been used to justify dramatic changes in settlement patterns imposed by the STATE. Examples might include the creation of *ujamaa* villages in Tanzania in the 1970s, the collectivization of Soviet agriculture in the 1930s and transmigration policy in Indonesia from the 1970s. It has also been the rationale for market-oriented reforms in response to the increasing popularity of NEO-LIBERALISM in the closing decades of the twentieth century. This has resulted in STRUCTURAL ADJUSTMENT PROGRAMMES (SAPs) imposed by the WORLD BANK in many poor countries, as well as pressures for improved GOVERNANCE to reverse the worst abuses of state control. Development can also refer to emancipation and autonomy at the level of the individual and the community, the processes of 'liberation' often identified with the writing of Paulo Freire. This perspective, which is popular (in all senses of the word) in Latin America, has resulted in rejection of 'development' as an imposition from the world of 'the West' and its replacement with a self-conscious anti-development-ism – a view clearly expressed by Arturo Escobar, which forms part of the NEW SOCIAL MOVEMENTS in contemporary Latin American politics and society.

Development as an outgrowth of Western culture

Development has particular cultural connotations and origins. It is a 'discourse' – a form of language code which sets agendas and the terms of discussion. It originates in Western European thought and has been used to set up a dichotomy between those countries and communities which are developed and those which are underdeveloped countries, LESS-DEVELOPED COUNTRIES or DEVELOPING COUN-

TRIES. These apparently similar terms differ from each other in their theoretical assumptions and references, and this fact underlines the importance of the language of development as part of its political nature. Most peoples and societies have had ideas about improvement and a better future, individually, collectively, materially or spiritually. These have often been expressed in religious or ethical terms – for example, the idea of redemption and salvation in Christianity and of enlightenment in Buddhism and Hinduism. However, in Western European thought the ideas became secularized as part of the intellectual ferment of the enlightenment in the seventeenth and eighteenth centuries. The growth of a view that the material world could be understood scientifically and therefore manipulated soon led to the belief that this was true also of the social world. The origins of POLITICAL ECONOMY may be seen in this perspective, whereby people consider that the social and economic world can be the object of conscious manipulation like a great machine. This achieves its highest (and, in some respects, somewhat ridiculous) expression in the ideas of St Simon and Comte. Founders of the discipline of sociology, these thinkers claimed to identify processes of material and intellectual development in human history that led to progressive intellectual enlightenment. The result of this was to be the creation of sociology, 'queen of the sciences', handmaiden of government in the pursuit of improved human conditions. Such ideas were widespread in the eighteenth and nineteenth centuries and continue to be. Most influential and clearly expressed in the writings of Hegel and MARX, they have been revisited and revised many times since, and are seen in MODERNIZATION THEORY. Apparently consistent with Darwin's ideas about evolution, the notion that societies go through processes of directional change and development may be found on the left, the right and at the centre of the political and ideological spectrum. FRANCIS FUKUYAMA's book, *The End of History and the Last Man*, published in 1992, is an example of the genre from the political right.

Post-modernism and development

Such evolutionist, large-scale views of the nature of development have come under sustained attack with the growing influence of POST-MODERNISM. Post-modernism has had much to say about development. In the sense in which it has been described so far, development has been a story, a narrative about where society, economy and culture have come from and where they are going. Post-modernism rejects such 'grand narratives', because they imply the superior position of the narrator. In the case of development, the narrator has often been the colonial power, the developed country giving aid, the international organization, but above all a voice from the North as opposed to the South.

Post-modern critiques are significant for the following reasons. (1) They endeavour to recapture the terms of the debate for the people of the South, 'the people without history', who have been accorded an inferior, 'subaltern', position in a process where they are the objects of technique and other people's history. This has resulted in writing which is sometimes described as post-colonial theory or as subaltern studies. (2) They are connected epistemologically and politically with ideas and writing in the fields of GENDER and sexual politics. The common factor is an effort by those who have been socially, economically and politically marginalized to revise the terms of the discussion so that they are the subjects and authors of action and policy rather than its objects. This perspective retains a concern with emancipation and betterment. (3) The post-modern approach may also reject the idea of development entirely, arguing that it is a discourse which has to do with control and regulation of resources, people, ideas and territories in the interests of the wealthy and of CAPITAL. Thus post-modernism rejects the idea of development and replaces it with a view that there is no grand narrative, that history seen through Western eyes is not everybody's history, and that people make their own way in the world according to their own cultural subjectivities and local circumstances. These

cannot and should not be assimilated to an alien history and future which remains in the hands of 'development experts'.

Post-modern perspectives are important for a further reason. They chime in with some popular currents in certain regions of the world. For example, rejection of development as it has arisen from within Western culture is consonant with many aspects both of the intellectual and popular arguments of fundamentalist religion. As development offers earthly salvation, it is in contradiction to the expectation of spiritual salvation in the next world offered by many systems of religious thought. This view, allied with experience of poverty and marginalization, means that in many places growing popular religiosity is allied to a rejection of development.

Post-modernism's criticism of the grand narrative has also resulted in serious criticism of those social sciences (such as sociology, social anthropology and some areas of economics) which claimed to provide the technical underpinning for development administered by states and large institutions. This has meant a refocusing of the disciplines as they apply to development both in terms of method and areas of empirical investigation. Research methods derived from POSITIVISM have been increasingly rejected in favour of participatory research, where the agenda and understanding is shared between the investigators and those whose lives are being investigated or even determined by them. This is the agenda of empowerment and participation which recognizes that older generalizing narratives of development need to be balanced or even replaced by an emphasis on the diversity of local conditions and identities. Such a methodological direction has led to new areas of empirical investigation. In agricultural development economics, the technical fix of the expert has been replaced by a concern with livelihood strategies; in social anthropology, the separation of the investigator and the investigated has been removed and it is now *de rigueur* for social anthropologists to locate themselves and their concerns in relation to people they study (or do not study – the word

'study' itself becomes problematic). Investigation is increasingly replaced by dialogue; knowledge about development is no longer the preserve of the expert, but is seen to be widely distributed.

We are left with a paradox. While intellectuals, some ordinary people and some politicians reject the goal or even the possibility of development, other intellectuals, other politicians, swathes of the world's poor and many states continue to demand it in its simplest forms: clean water, enough food, civil order and a future for their children.

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TONY BARNETT

Development Assistance Committee (DAC)

The Development Assistance Committee (DAC) is the donor's club at which matters of aid policy are discussed, aid data collected and

reported, and periodic reviews of donor performance carried out. The committee operates under the auspices of the ORGANISATION FOR ECONOMIC CO-OPERATION AND DEVELOPMENT (OECD) (and shares OECD's Paris headquarters) and most OECD members are also DAC members.

The DAC was founded in 1960 (called the Development Assistance Group for the first year of its existence) at a time when bilateral aid programmes were starting to proliferate. The original nine members of the DAC were Belgium, Canada, France, Germany, Italy, the Netherlands, Portugal, the United Kingdom and the United States; other countries have since joined, so that in 1998 there were twenty-one member-countries, plus the EUROPEAN UNION (EU), with other multilateral organizations having observer status.

The DAC has largely been concerned with technical aspects of aid management, and its various committees and working groups are dominated by aid-agency officials, rather than politicians, academics or other members of CIVIL SOCIETY (DAC should not be confused with the OECD's Development Centre, which is a research organization). More striking still is the absence of any voice for aid recipients within the DAC. This fact is no coincidence. In the 1960s, the UNITED NATIONS CONFERENCE ON TRADE AND DEVELOPMENT (UNCTAD) rivalled DAC as the body pronouncing on aid policy, for example proposing that the required grant element to qualify as OFFICIAL DEVELOPMENT ASSISTANCE (ODA) should be 50 per cent, rather than the 25 per cent adopted by DAC. However, donors were reluctant to have a body dominated by developing countries take this role.

It would be difficult to argue that DAC has had a profound influence on trends in aid quality or practice. While some trends, such as the terms of aid, have moved in accordance with DAC recommendations, others, such as tied aid or meeting the 0.7 per cent target, clearly have not.

See also:

aid; aid, multilateral; aid, tied

Further reading

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HOWARD WHITE

development of underdevelopment

The phrase 'the development of underdevelopment' was coined by ANDRE GUNDER FRANK in his path-breaking 1966 article, which has been reprinted several times in numerous publications and translated into many languages. The phrase has circulated widely since then, although reference to it has become less common after the heyday of dependency theory during the 1970s. Frank's notion of UNDERDEVELOPMENT is almost the same as the concept of DEPENDENCE used by most dependency theorists. A major influence on Frank's thesis were the writings of PAUL BARAN who, as early as the 1950s, argued that the penetration of capitalism in the LESS-DEVELOPED COUNTRIES (LDCs) resulted in backwardness rather than progress.

With his thesis of the development of underdevelopment, which states that the development of the centre countries is due to the EXPLOITATION of the peripheral countries and that the underdevelopment of the periphery is due to the development of the centre countries, Frank turned MODERNIZATION THEORY and orthodox development theory on its head. For Frank, the now developed countries (DCs) were never underdeveloped, though they may have been undeveloped. By contrast modernization theory, which held sway in the sociology of development, argued that traditional socie-

ties should follow in the footsteps of modern societies, and that the best and quickest way to develop for the LDCs was to weave even closer economic, social, political and cultural links with the DCs. This traditional/modern dichotomy was transformed in development theory into the stages of economic growth doctrine by W.W. ROSTOW, who argued that LDCs should follow a similar pattern of growth and change to that pursued by the capitalist DCs.

Furthermore, in contrast to the modernization and orthodox development theories, the 'development of underdevelopment' and dependency theses argue that underdevelopment or dependence originates from the incorporation and subordination of LDCs into the world capitalist system, either through COLONIALISM and IMPERIALISM or through trade and investment relations, and that this will continue as long as LDCs remain tied to it. These propositions blame foreign trade and foreign investment for the underdevelopment and dependence of the LDCs, as through these economic linkages a surplus (or, more precisely, SURPLUS VALUE) is extracted by the DCs (the 'metropolitan countries' in Frank's terminology) from the LDCs (or 'satellite countries'). This economic surplus can take the form of profit remittances, royalty payments, TRANSFER PRICING, UNEQUAL EXCHANGE, interest payments and pillage, among others. It follows from such a diagnosis that only a process of DELINKING and a path of AUTONOMOUS DEVELOPMENT within a transition to SOCIALISM can lead to development. Such a view was in direct opposition to the dominant modernization and development paradigms of the time.

Frank's thesis of the development of underdevelopment has been challenged on a number of grounds. Fernando Cardoso (1977) rejects the notion of the development of underdevelopment for implying that LDCs are either stagnating or that capitalist development is unviable. He argues that rapid economic growth has taken place in LDCs and that the forces of production have been developed, particularly since the new phase of dependence associated with Latin America's industrialization under the aegis of MULTINATIONAL

development of underdevelopment

CORPORATIONS (MNCs). Cardoso does not deny that capitalist development in dependent countries is highly uneven, unequal and full of contradictions, but this does not mean that no development takes place or that it is unviable. In place of what he sees as the mistaken notion of the development of underdevelopment, Cardoso proposes the term DEPENDENT DEVELOPMENT as a more accurate representation of the processes of development *and* dependency in LDCs.

Orthodox Marxists also criticized Frank as, in their view, it is the very lack, or insufficient penetration, of capitalism in DEVELOPING COUNTRIES which creates and perpetuates underdevelopment. The essential issue is the scale and rate of accumulation, and not the origin of the capitals involved. Given the dearth of capital in LDCs, foreign capital can make a significant addition to the accumulation and thus development process of developing countries. Some critics (for example, Bill Warren) even view imperialism as a progressive force in world development and particularly in LDCs. Others criticize the development of underdevelopment thesis for establishing a chain of causality between foreign capital and underdevelopment, thereby disregarding the role of internal factors. According to this view, underdevelopment is produced by the internal class structure of the LDC. This, rather than the appropriation of surplus by metropolitan capital (significant though this may be), impedes the development of the productive forces either by failing to provide sufficient incentives and opportunities for capital investment or by squandering the limited resources available through conspicuous consumption or unproductive and speculative investments.

This last point focuses on criticisms of Frank's analysis of class, in which he conceptualizes not only exploiting classes and exploited classes as in Marxist analysis, but also classes which both exploit and are exploited at the same time. In Frank's schema, every class between the peasant at the bottom of the ladder and the metropolitan bourgeoisie at the top is simultaneously exploited by the class above it (its metropolis) and exploits the

class below it (its satellite). This type of class formulation implies that while the urban working class is exploited by the urban bourgeoisie, it in turn exploits the peasantry. The problem is that Frank formulates his development of underdevelopment framework in regional (metropolis-satellite or centre-periphery) rather than in class terms.

With his development of underdevelopment thesis, Frank also made a significant intervention in the mode of production controversy. By arguing that capitalism was the cause of underdevelopment and responsible for the development of its underdevelopment, he challenged communist party orthodoxy that Latin America was still feudal and that popular forces should support the bourgeoisie in order to fulfil the revolutionary task of accelerating the transition from FEUDALISM TO CAPITALISM. This progressive role of the bourgeoisie would in turn facilitate the growth of the proletariat, thereby bringing the triumphant socialist revolution nearer. According to Frank, the THIRD WORLD bourgeoisie – which he labelled a 'lumpenbourgeoisie' (see COMPRADORS) – was only perpetuating the development of underdevelopment or 'lumpenddevelopment'. Following the example of the Cuban revolution, capitalism had to be overthrown as only socialism could eliminate underdevelopment.

Frank has been criticized for failing to analyse the internal social RELATIONS OF PRODUCTION and for defining capitalism primarily with reference to external exchange relations. Frank later revised his characterization of the social relations of production by holding that these have not necessarily been capitalist since the colonial period, as he first argued. While continuing to maintain that Latin America's mode of production has been capitalist since the colonial period, he now specifies that a variety of pre-capitalist, non-capitalist and even post-capitalist relations have contributed to, and to a lesser extent still contribute to, the process of capital accumulation. His main thesis, however, still stands: the underdeveloped countries have made a crucial contribution to the process of capital accumulation and economic development in the now

DCs which, at the same time, 'developed the mode of production which underdeveloped Asia, Africa and Latin America' (Frank, 1978: 172).

Some critics have argued that this representation is historically inaccurate. Historical research has shown that the development of the centre countries was mainly due to the internal creation, appropriation and use of the surplus, and had less to do with the pillage or exploitation of the peripheral countries. The reasons for the successful development of the now DCs have to be sought principally in the particular economic, social and political institutional framework which they created, and which was amenable to capital accumulation and innovation. This is not to deny that an economic surplus was transferred from the LDCs to the DCs, and that this facilitated the development of the latter and created major problems for the former. What is being argued is that development and underdevelopment are primarily rooted in the internal social relations of production and not in the external relations of exchange.

See also:

core-periphery model; dependency theory; world-systems theory

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CRISTÓBAL KAY

developmental state

Developmental states have been defined as those

whose politics have concentrated sufficient power, autonomy and capacity at the centre to shape, pursue and encourage the achievement of explicit developmental objectives, whether by establishing and promoting the conditions and direction of economic growth, or by organising it directly, or a varying combination of both.

(Leftwich, 1995: 401)

The origins of the concept of the developmental state can be located in the nineteenth-century national system of political economy

developed by FRIEDRICH LIST and the German Historical School (see HISTORICAL SCHOOL, GERMAN). More recently, the concept has been most closely associated with explanations of East Asian industrialization. Indeed, it was in Chalmers Johnson's seminal work on Japanese industrial policy that the concept of the developmental state was first systematically developed (Johnson, 1982), before being applied to South Korea (Amsden, 1989) and other parts of East Asia (Wade, 1990; Gills *et al.*, 1996).

The 'plan rational' developmental state, in which primacy is given to an effective industrial policy: that is, 'a concern with the structure of domestic industry and with promoting the structure that enhances the nation's international competitiveness', is to be distinguished from

[the] plan ideological Soviet-type command economy, where state ownership and planning became not means to development but fundamental values, and the regulatory, market-rational United States economy, where the maintenance of competition and consumer choice has been accorded primacy.

(Johnson, 1982: 18–20)

For Johnson, the four essential features of the developmental state are the existence of a small, inexpensive but elite bureaucracy to formulate and supervise the implementation of an industrial policy; a political system in which the bureaucracy is given sufficient scope to take the initiative and operate effectively; the perfection of market-conforming methods of state intervention in the economy; and the presence of a pilot organization, like Japan's MINISTRY OF INTERNATIONAL TRADE AND INDUSTRY (MITI), with a mix of powers which neither give it control over so many sectors as to make it all-powerful, nor so few as to make it ineffective (*ibid.*: 315–20).

Acknowledging that the linkage between the state and development theory is still in its infancy, Adrian Leftwich has identified six major components of a preliminary model of the developmental state, based on his under-

standing that 'fundamentally political factors have always shaped the thrust and pace of their developmental strategies through the structures of the state' (Leftwich, 1995: 401). Leftwich's preliminary model shares many of the features of Johnson's original conceptualization of the developmental state.

First, Leftwich points to the importance of a determined developmental elite as the focal point for a state-led industrialization strategy. Second, he has emphasized the relative but embedded autonomy or insulation of these elites and the state institutions which they command from the demands of special interests (whether class, regional or sectoral) which have been overridden in the national developmental interest. Third, Leftwich has identified the power, technical competence, political insulation and penetration of the economic bureaucracy which organizes the critical interactions between the state and the economy. Fourth, he emphasizes the fact that developmental states have generally operated in social contexts where CIVIL SOCIETY has been suppressed or weak to begin with. Fifth, Leftwich has noted that in developmental states, state power and autonomy were consolidated before national or foreign capital became influential, enabling the economic bureaucracy to enjoy powerful leverage over the private sector. Sixth, developmental states have combined a willingness to brutally suppress civil rights with a wide degree of legitimacy and a sustained performance in delivering developmental objectives. Leftwich has contended that this combination of repression and legitimacy is best accounted for by the highly equitable distribution by most developmental states of the fruits of rapid economic growth (*ibid.*: 401–18).

Given this character, Leftwich has concluded that the developmental state model is not confined to Confucian East Asia but is also found in Islamic South-East Asia, and parts of Africa and Europe. Because they are 'mobilising states in which political and bureaucratic components have been virtually fused' (Leftwich, 1995: 420), the developmental state does not fall clearly into either the Marxist or

Weberian theories of the state. Furthermore, developmental states are dynamic, rather than static, entities which vary with respect to all of Leftwich's six key components, depending on their particular historical, cultural, social and political development. Above all, Leftwich has concluded that the forms and features of the developmental state demonstrate the primacy of politics (*ibid.*: 421).

Because the developmental state model of rapid industrialization depends on the presence of 'a strong and autonomous state, providing directional thrust to the operation of the market mechanism' (Onis, 1991: 110), Ziya Onis has suggested that there are at least three major reasons why the developmental state is inapplicable as a model of development for mature liberal democracies, not least those such as Britain which have experienced relative economic decline. First, the developmental state model requires 'single minded adherence to growth and competitiveness at the expense of other objectives' (*ibid.*: 120), but liberal democracies cannot overlook the competing demands of the welfare state. Second, developmental states in East Asia have enjoyed an 'unusual degree of bureaucratic autonomy and capacity' (*ibid.*: 114) through their insulation from the political tensions of an industrializing society. However, this insulation was primarily achieved through political repression and the curtailment of the power of organized labour in a systematic manner which would not be tolerated in a mature liberal democracy. Third, developmental states have been characterized by a 'unique and unusual degree of public-private cooperation' made possible by a significant degree of compulsion and the 'extraordinary degrees of monopoly and control exercised by the state conglomerates on bank finance' (*ibid.*: 116). The feasibility of this form of intervention for European and American economies operating in a world of increasingly liberalized financial markets was extremely dubious long before its legitimacy was undermined by the financial crises that have afflicted both Japan (since the collapse of its 'bubble economy' in 1990) and many other Asian

economies (in the financially turbulent final months of 1997).

Onis has concluded that the East Asian developmental state model is 'inconsistent with the vision of a pluralistic form of democracy' (*ibid.*: 119) of the European or North American types. This fact has not prevented many British commentators in particular from regarding the developmental state as a model to be replicated to remedy faltering economic performance in the United Kingdom, especially in the manufacturing sector (for example, Smith, 1984).

As the father of developmental state theory, Chalmers Johnson is in no sense responsible for this reductionist application of the East Asian developmental state to inappropriate and alien economies. At the conclusion of his seminal work on Japanese industrial policy, he acknowledged that his conception of the developmental state was 'only a model, and a sketchy one at that' (Johnson, 1982: 320), which could not be reduced to a specific device or institution, and which had been, for Japan, 'the product of one of the most painful passages to modernity' (*ibid.*: 306-7) that any industrializing nation had ever had to endure. Indeed, a rival economy, such as that of the United States, should not seek to enhance its competitiveness by replicating Japan's institutional structures, through the addition of 'still another layer to its already burdensome regulatory bureaucracy' (*ibid.*: 323). On the contrary, the US and other competitors to Japan would be better advised 'to fabricate the institutions of their own developmental states from local materials' which, in the case of the US, would mean unleashing 'the private, competitive impulses of its citizens' (*ibid.*: 323). By this interpretation, the efforts during the 1980s of the Reagan administration in the US and the Thatcher governments in the UK to roll back the frontiers of the state and to restore the role of entrepreneurial initiative as the prime mover of social change, while simultaneously increasing spending on their respective military-industrial bases, could be seen as effective occidental variants of the East Asian developmental state.

The validity of the developmental state as an explanation for the economic performance of the East Asian economies in particular has received important subsequent qualification from the work of David Friedman and FRANCIS FUKUYAMA. Friedman has contended that Johnson's developmental state model has misunderstood Japan's post-war economic performance because, in studying industrial policies 'in isolation from the industrial and political context in which they were formed and administered', it has asserted what remains to be proven, namely that 'legislation administered by MITI is evidence of successful, independent government guidance' (Friedman, 1988: 29). From his analysis of the machine-tool industry, Friedman has countered that there is little evidence that MITI and its predecessors guided industrial development. Indeed, 'it seems more likely that, at best, policies resulted from a compromise forced on the bureaucracy, or even that business constrained the state' (ibid.: 30).

Fukuyama has argued that far from economic performance being dependent on the effective suppression and subordination of civil society by the developmental state, civil society has been instrumental to the success of economies such as the Japanese by virtue of its very strength. The thriving civil society in Japan has enhanced not only its social capital – that is, the capacity of people to work together for common purpose in groups and organizations, not least businesses – but also its spontaneous sociability – that is, 'the capacity to form new associations and to cooperate within the terms of reference they establish' (Fukuyama, 1995: 27). Because most activities in the wealth-creating process are undertaken in groups rather than in individual isolation, the trust that has arisen from the social capital, spontaneous sociability and shared set of values in Japan and similar societies has significantly impacted on the vitality and scale of economic organization and performance (ibid.: 101).

Friedman and Fukuyama's respective theses have downgraded the importance of the role of the developmental state in explanations of

economic performance in East Asia by raising the profile of the fundamentally political character of state-market relations and the importance of the contribution of non-state, societal actors to economic organization. However, perhaps the greatest challenge to the developmental state as a model for new industrializing economies is the dramatically changed international environment in which it must now operate. The developmental states of East Asia achieved their rapid industrialization during the post-war, pre-oil crisis era of the Bretton Woods international economic order (see BRETTON WOODS SYSTEM), which for a generation delivered unprecedented sustained non-inflationary growth in the world economy, accompanied by a tolerance of tariff- and non-tariff barriers erected in defence of East Asian infant industries. The contemporary world economy of highly competitive export markets, lower overall world economic growth, privatization and deregulation demands open liberalized markets from even the lesser developed economies. Therefore, the developmental state, or at least its post-war East Asian variant, may no longer be a suitable or indeed feasible path to industrialization in the new millennium.

See also:

East Asian model; industrial policy

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SIMON LEE

Dillon Round

The fifth round of tariff negotiations of the GENERAL AGREEMENT ON TARIFFS AND TRADE (GATT) opened in September 1960 and took two years. The negotiations were proposed by and named in honour of Douglas Dillon, Under Secretary of State of the United States at that time.

Following the establishment of the EUROPEAN ECONOMIC COMMUNITY (EEC) in 1957, the Dillon Round was divided into two phases. The first was concerned with negotiations,

under Article XXIV: 6 of the General Agreement, between EEC member-states and the other non-EEC members of GATT. The purpose was to create a single schedule of concessions for the EEC, based on its own Common External Tariff. Article XXIV: 6 provides that in cases where, in the context of the formation of a CUSTOMS UNION (CU), a member-state proposes to increase any bound rate, the procedures set forth in Article XXVIII of the General Agreement (regarding the modification or withdrawal of a concession) shall apply. The second phase was a further general round of multilateral tariff negotiations on a large-scale basis.

The Dillon Round was concluded in July 1962 and yielded modest results: only 4,400 tariff concessions, covering \$4.9 billion of trade, were exchanged. Agriculture and certain sensitive products were not covered at all. The Dillon Round was followed by the KENNEDY ROUND (November 1963–May 1967), which was much more successful and resulted in the first multilateral agreement under the auspices of GATT on non-tariff measures.

N.M. DUYKERS

diminishing returns

The 'law' of diminishing returns applies to any factor of production that is varied while the other factors are held constant. In general terms, the law says that output will vary if different quantities of the variable factor(s) of production are applied to one or more factors of production that are fixed. In more concrete terms, it means that an additional amount of input will add less to total output than the previous unit. Diminishing returns arise beyond some level of input. Assuming that the quantity of labour used is variable and capital is the fixed factor of production, diminishing returns are the result of the fact that more and more workers are using the same machines and are working in the same space. In such a situation, additional workers can do less that is productive. Since the output of an additional

unit of the variable factor is called 'marginal product', one may also speak of 'diminishing marginal product'.

Marginal product might decline from the outset, but it might also rise initially and fall at a higher level of output. Therefore, it would be more correct to speak of increasing and decreasing returns. Assume that there is a bakery with a fixed supply of baking ovens and related equipment, and one worker who must do all the tasks. With one worker it is impossible to use all available ovens and other equipment. If more workers are added, however, more ovens can be used. Moreover, if sufficient workers are hired, they can specialize in one task, which gives rise to a more efficient division of labour. As a result, each newly hired worker will add more to total product than each previous worker did. Marginal product will increase, which is a situation of increasing returns. Thus, as the firm hires additional workers, the bakery becomes at first more productive in terms of its output.

However, the scope for such economies will fade away and eventually marginal products of additional workers will decrease. As workers continue to be added, the gains in output will begin to slow down, since each additional worker has less ovens and related equipment to work with. As soon as an additional worker adds less to total output than the preceding worker does, the point of diminishing returns has been reached. At this stage, each newly

hired worker will increase total output by less than the previous hired worker did.

The Table 1 illustrates the law of diminishing returns. The first worker hired produces a total output of 20 (loafs of bread). The second worker produces 25, thereby increasing total output to 45. His marginal product exceeds that of the first worker, so this is the stage of increasing marginal returns. The third worker produces 30 and increases total output to 75. Since the third worker adds more to total output than the second, marginal returns are still increasing. The fourth worker, however, adds 25 to total output, which is less than what the third worker added. Obviously, the point of diminishing marginal returns has been reached at the fourth worker. Each additional worker adds a diminishing amount to total output. The fifth worker adds 20, the sixth worker 15 and so on. This is the result of the fact that more and more workers have to work with a fixed quantity of capital (ovens and related equipment), so that each additional worker has less of this capital to work with.

M. PETER VAN DER HOEK

diplomacy

Generally referring to the management of international relations (IR) by negotiation, diplomacy is what Hedley Bull defines in *The Anarchical Society* as the 'conduct of relations between states and other entities with standing in world politics by official agents and by peaceful means' (Bull, 1995: 162). It is a peaceful instrument by which states seek to promote their interests or, when doing so does not threaten their vital interests, to promote humanitarian objectives.

Bull points to four main functions of diplomacy:

- 1 it facilitates communication between state leaderships and other actors in international politics;
- 2 it serves the negotiation of international agreements;

Table 1 Law of diminishing returns

<i>Number of total workers</i>	<i>Output</i>	<i>Marginal product</i>
1	20	20
2	45	25
3	75	30
4	100	25
5	120	20
6	135	15
7	145	10

- 3 it functions to gather information about foreign countries;
- 4 it helps to minimize friction or tensions in international politics.

While diplomacy has been practised for as long as there have been groups of people controlling territories, its modern form was codified in the Treaty of Westphalia of 1648 (see WESTPHALIA, TREATIES OF) and the institutions of diplomacy: exchange and official recognition of diplomatic representatives, the establishment of diplomatic embassies in other states and the implementation of diplomatic immunity. Through history, diplomacy has been an important means of maintaining contact between governments. However, with modern communications technologies, diplomats are less critical, although face-to-face negotiations remain an important part of IR.

While we generally think of diplomacy as negotiations between states and their representatives, diplomacy is practised by non-state actors – notably by the representatives of international organizations like the UNITED NATIONS (UN) and the EUROPEAN UNION (EU), by entities not yet recognized as sovereign states (for example, Palestine), and by sub-state governments (for example, California and Bavaria) and NON-GOVERNMENTAL ORGANIZATIONS (NGOs), whom governments occasionally deputize to perform diplomatic functions.

Effective diplomacy must arguably be backed by some form of power, whether the implied threat is of armed force or, as is more common today (at least from the most affluent states), the threat of economic sanctions. The latter measure has been used with increasing frequency, if limited efficacy, by the United States. The United States has greater luck when it threatens to restrict the imports of countries whose markets it is trying to open to US products and services. Having said this, it is important to point out that many 'weak' states are surprisingly effective in promoting their interests through diplomacy.

Diplomacy is a central feature of international economic relations. Indeed, even trade

wars between states are characterized by vigorous, often public, diplomacy in an effort to take the moral (and economic) high ground. The most notable manifestations of international economic diplomacy, beyond ongoing bilateral deliberations, have been the negotiating rounds of the GENERAL AGREEMENT ON TARIFFS AND TRADE (GATT) and its successor, the WORLD TRADE ORGANIZATION (WTO).

See also:

Uruguay Round

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PAUL G. HARRIS

diplomacy, economic

'Diplomacy' may be defined as the art or practice of international relations (IR). 'Economic diplomacy', in turn, refers to the dynamic interaction between economics and politics in the conduct of diplomacy. 'Economic diplomacy' has two general usages: it refers to the use of economic resources or the manipulation of economic activity for diplomatic purposes, and to the use of diplomacy to promote financial or commercial objectives.

Economic diplomacy, in the first sense, has a

long history in foreign policy and has taken a variety of forms, including MERCANTILISM, ECONOMIC NATIONALISM, dollar diplomacy and economic statecraft. Contemporary scholars in this genre, including ALBERT HIRSCHMAN, KLAUS KNORR and David Baldwin emphasize the promise, threat or use of economic sanctions, embargoes and foreign aid to achieve political objectives (see AID; SANCTIONS, ECONOMIC). This can be done unilaterally (as in the current United States embargo against Cuba) or multilaterally (as with the United Nations arms embargo against combatants during the Bosnian conflict in the 1990s). Embargoes like these are intended to compel states to change their behaviour by denying them access to goods and services. Other cost-inflicting means include boycotts or blacklisting; increasing trade barriers; DUMPING; suspending or reducing aid; freezing assets; expropriation; increasing taxation; withdrawal of MOST-FAVOURLED-NATION treatment; or withholding dues or denying membership of a multilateral economic organization. Rather than imposing costs, states may offer economic inducements or 'positive sanctions' to entice others to alter their behaviour. Foreign aid, for example, is often used to show support and bolster relationships between states. Other types of inducements include increased trade or INVESTMENT; the granting of licences for imports or exports; increased access to government contracts; investment incentives or guarantees; offers of most-favoured-nation treatment, and offers of membership of multilateral economic organizations.

Economic diplomacy also refers to the use of political means to achieve international economic objectives. Some argue that dominant powers, such as nineteenth-century Great Britain and twentieth-century United States, have used their military and diplomatic power to structure favourable economic outcomes. Institutions like the WORLD TRADE ORGANIZATION (WTO) also host numerous intergovernmental negotiations regarding trade issues including non-discrimination, INTELLECTUAL PROPERTY RIGHTS (IPRs), labour and environmental standards, and competition policy.

Economic diplomacy, in this sense, has taken a variety of forms including economic management, strategic trade policy, protectionism, assertive unilateralism, 'levelling the playing field' and IMPERIALISM. Scholars in this genre, including Michael Porter, Paul Krugman and Laura Tyson, analyse the role of government intervention in offsetting the risk of high adjustment costs for domestic firms, potential terms of trade losses, or the threat to NATIONAL SECURITY resulting from international competition and the decline of strategic domestic industries. Research suggests that the benefits of economic diplomacy vary significantly depending on the form of government intervention, its impact on other industries, and the reactions of domestic firms, foreign firms and foreign governments.

While economic diplomacy has become increasingly prominent since the end of the COLD WAR, critics argue that manipulating economic incentives and intervening in the market may yield negative political and social consequences. While economic diplomacy may be used as an alternative to war, it often inflicts harm on innocent people and may indeed be a 'trap door for war' rather than a 'threshold for peace'. Some, like JOHN MAYNARD KEYNES, argue that in the absence of multilateral management, unbridled economic competition could lead to trade wars and even military conflict. Others, like JOHN STUART MILL, argue that intensified economic interaction could create overlapping interests that would enhance diplomacy and render war obsolete. Both are possible for, as Carl von Clausewitz might argue, economic diplomacy is merely politics by other means.

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GEORGE E. SHAMBAUGH

diseconomies of scale

'Diseconomies of scale', or 'decreasing returns to scale', occur when average costs increase in the long run despite increasing output. The concept of diseconomies of scale emerged from questioning whether costs continue to fall indefinitely as the size of an organization increases. Empirical evidence suggests that this frequently does not happen, largely because ECONOMIES OF SCALE are balanced or exceeded by diseconomies of scale.

Diseconomies of scale largely arise from the inefficiencies that creep into any large organization, often as a result of the growth of BUREAUCRACY. They are most likely to occur in management, reflecting the difficulty of controlling and administering large organizations. Once a firm reaches a certain size, departments and committees are created on the principle of DIVISION OF LABOUR. While this may be necessary in order for the organization to function effectively, it can create problems for decision-making since such departments often must be consulted about their interests before a decision is reached. Such bureaucratic problems inevitably hinder the ability of a large firm to respond to changes in market conditions, particularly changes in demand for a firm's products or services. Failure to respond quickly to such changes may mean that a large-scale producer continues to produce goods or services that are no longer in demand.

Other diseconomies of scale may arise from the increasingly impersonal nature of a large organization. Inevitably, once a firm reaches a certain number of employees, there is a loss of personal contact between senior management and the workforce. Under such circumstances, this can create an adversarial relationship – a 'them and us' attitude. Employees feel that they are a small cog in a big wheel, that decision-making is out of their hands and that no one listens to their complaints. This inevitably affects efficiency and motivation adversely. Customer care can also be affected by the size of the organization. Customers may not be dealt with as quickly or as politely as in a small

firm – there may be a lack of personal attention creating the impression of a faceless bureaucracy. This may affect customer goodwill and loyalty.

Finally, EXOGENOUS FACTORS may also result in diseconomies of scale. For example, a mining firm will extract minerals which are easily accessed first. However, deeper seams may have to be mined to produce a higher output, which will incur more expense. In such cases, a point may be reached where returns begin to diminish.

In an attempt to prevent some of the potential diseconomies of scale, many firms have increasingly adopted decentralized systems of management, allowing many decisions to be made at lower levels of the organization – even on the production line or shopfloor (encouraging, for example, team-working and quality circles). The rationale for such changes is that, in effect, it is like having an array of semiautonomous firms under one corporate umbrella, allowing the organization to enjoy the benefits of economies of scale without the costs of diseconomies.

JASON P. ABBOTT

disengagement

The international political economy (IPE) literature uses the term 'disengagement' to depict some degree of national retreat from open international trade. Disengagement from the world economy traditionally reflects a Marxist-oriented national development strategy of retrenchment from the world capitalist economy (see MARXIAN ECONOMICS; CAPITALISM) and associated problems of dependency. To most advocates of disengagement, even milder forms of retrenchment (such as policies undertaken by countries to buffer themselves from the perceived adverse effects of GLOBALIZATION and external dependency) are unacceptable alternatives.

At the heart of the disengagement argument is the notion that markets are highly flawed. For Marxists, market instabilities arise from

the inherent contradictions of capitalism and they can be resolved only by transitional strategies of disengagement from market relations. Also rejected by advocates of disengagement is the social democratic Keynesian notion (see SOCIAL DEMOCRACY; KEYNESIAN ECONOMICS) that the market simply needs to be regulated to remove certain specific constraints which prevent capitalism from reaching the volumes of output associated with full employment.

In developing countries, advocates of disengagement usually accept the dependency arguments of ANDRE GUNDER FRANK. Frank, writing in the mid-1960s, criticized the view of many DEVELOPMENT scholars that contemporary underdeveloped countries resemble the earlier stages of now-developed countries. Many of these scholars view modernization in LESS-DEVELOPED COUNTRIES (LDCs) as simply the adoption of economic and political systems developed in Western Europe and North America.

For Frank, the presently developed countries were never underdeveloped, though they may have been undeveloped. His basic thesis is that UNDERDEVELOPMENT does not mean traditional (that is, non-modern) economic, political and social institutions, but LDC subjection to the colonial rule and imperial domination of foreign powers (see COLONIALISM; IMPERIALISM). In essence, Frank sees underdevelopment as the effect of the penetration of modern capitalism into the archaic economic structures of their world. He sees the DEINDUSTRIALIZATION of India under British colonialism, the disruption of African society by the slave trade and subsequent colonialism, and the total destruction of Indian civilizations by the Spanish conquistadors as examples of the creation of underdevelopment.

More plainly stated, the economic development of the rich countries contributes to the underdevelopment of the poor. Development of an LDC is not self-generating or autonomous, but ancillary. The LDCs are economic satellites of the highly developed regions of North America and Western Europe in the international capitalist system. The Afro-Asian

and Latin American countries most weakly integrated into this system tend to be the most highly developed. Japanese economic development after the 1860s is the classic case illustrating Frank's theory. Japan's industrial growth was unprecedented; Japan was never a capitalist satellite.

Frank suggests that satellite countries experience their greatest economic development when they are least dependent on the world capitalist system. Thus Argentina, Brazil, Chile and Mexico grew most rapidly during World War I, the GREAT DEPRESSION and World War II, when trade and financial ties to major capitalist countries were weakest. According to Frank, it is significant that the most underdeveloped regions today are those that have had the closest ties to Western capitalism in the past. They were the greatest exporters of primary products to and the biggest sources of CAPITAL for developed countries, and were abandoned by them when for one reason or another business fell off. Frank points to India's Bengal and the sugar-exporting West Indian nations as prime examples of this phenomenon.

It is an error, Frank feels, to argue that the development of the underdeveloped countries will be stimulated by the indiscriminate transfer of capital, institutions and values from developed countries. He suggests that, in fact, the following economic activities have contributed to underdevelopment rather than development:

- 1 The replacement of indigenous enterprises with technologically more advanced global subsidiary companies.
- 2 The formation of an unskilled labour force to work in factories and mines, and on plantations.
- 3 The recruiting of highly educated youths to junior posts in the colonial administrative service.
- 4 The migration of workers from the villages to the foreign-dominated urban complexes.
- 5 The opening of the economy to trade with and investment from developed countries.

It follows that a THIRD WORLD country can only develop by withdrawing from the world capitalist system.

Disengagement has found numerous political supporters in the developing world, especially in Africa in the early 1980s. At that time, many countries were suffering from poor economic performance. This was interpreted by statesmen as a further manifestation of the problems of dependence. As Adedeji has noted:

the African economy today is the most open and the most exposed economy in the world, overly dependent on external trade and other external stimuli, foreign technology, and foreign expertise. The very strategies of development the African governments have been pursuing since independence have come from outside, derived as they were from theories of economic development that were developed during the colonial and neocolonial periods to rationalize the colonial pattern of production in Africa. Not unexpectedly, those foreign theories of development and economic growth reinforce the economic dependence of Africa ... the cumulative result is that, today, neither high rates of growth or diversification nor an increasing measure of self-reliance and self-sustainment has been achieved in the African Economy.

(Adedeji, 1982: 76)

The collective African response in the early 1980s was to advocate disengagement as a precondition for development. While national and regional experiences differ, the African case illustrates many of the rationales given for disengagement. These include:

- 1 disappointing development performances in most of Africa;
- 2 unpromising projections for the rest of the twentieth century/early twenty-first century (based on current trends);
- 3 inappropriate development policies – modernization assumptions seemed to lead to dependence rather than development or autonomy;

- 4 failure of demands for a NEW INTERNATIONAL ECONOMIC ORDER (NIEO) – Africa was not to be saved by a grand reordering of the global economy;
- 5 increasing inequalities between and within African states that undermined progress toward national and regional INTEGRATION, and
- 6 growing determination of African institutions and leaders to assert their own path – their own pedagogy and philosophy – and resist continued extra-continental pressures.

Most of these ideas were incorporated into the LAGOS PLAN OF ACTION (LPA) (1981) which called for retreat from the world capitalist economy and increased regional integration and self-reliance.

Milder forms of disengagement stem from trade pessimism which focuses on three basic themes: (1) the limited growth of world demand for primary exports, (2) the secular deterioration in the TERMS OF TRADE for primary-product exporting nations and (3) the rise of 'new protectionism' against the exports of LDC manufactured and processed agricultural goods.

LDC exports grow slowly because of (1) a shift in developed countries from low-technology material-intensive goods to high-technology skill-intensive products, which decreases the demand for raw materials from the Third World; (2) increased efficiency in industrial uses of raw materials; (3) the substitution of synthetics for natural raw materials like rubber, copper and cotton; (4) the low INCOME ELASTICITY OF DEMAND for primary products and light manufactured goods; (5) the rising productivity of agriculture in developed countries, and (6) the rising tide of protectionism for both agriculture and labour-intensive industries in developed countries.

The terms of trade deteriorate because of (1) oligopolistic control of factor and commodity markets in developed countries, combined with increasing competitive sources of supply of LDC exportables, and (2) a generally lower level of income elasticity of demand for LDC exports.

disequilibrium

The rise of new protectionism in the developed world results from the very success of a growing number of LDCs in producing a wider range of both primary and secondary products at competitive world prices, combined with the quite natural fears of workers in higher cost industries in developed countries that their jobs will be lost. These workers put pressure on their governments in Europe, Japan and North America to curtail or prohibit competitive imports from the Third World.

The trade pessimists therefore advocate a certain level of disengagement from world trade because, in their view, this activity hurts Third World development because (1) the slow growth in demand for their traditional exports means that export expansion results in lower export prices and a transfer of income from poor to rich nations; (2) without import restrictions, the high elasticity of Third World demand for imports combined with the low elasticity for their exports means that developing countries must grow slowly to avoid chronic BALANCE OF PAYMENTS and FOREIGN EXCHANGE crises, and (3) as long as developing nations have their static comparative advantage in primary products, export-promoting FREE TRADE policies tend to inhibit industrialization, which is in turn the major vehicle for the accumulation of technical skills and entrepreneurial talents.

See also:

delinking; dependency theory; unequal exchange

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ROBERT LOONEY

disequilibrium

The disequilibrium approach is a school within the macro-economic literature of the 1970s and the 1980s, that was developed as a dynamic and modern version of the neo-Keynesian paradigm of the 1940s. The Disequilibrium School revived the MONETARISM versus Keynesianism (see KEYNESIAN ECONOMICS) debate on the neutrality of money (the contention that changes in money's quantity do not affect output in the long run) and on the role of prices in macro-economic adjustments.

Belonging to the neo-Keynesian paradigm, the Disequilibrium School emphasized price rigidity and output constraints (hence 'disequilibrium') as the causes of fluctuations in output. But, contrary to old neo-Keynesian thinking, it used inter-temporal models, with sound conclusions for the long term, and focused on market failures and micro-economic coordination problems as sources for non-neutrality.

Thus wage rigidities could reveal the workers' preference for wage stability rather than employment stability. This is explained by the determination of wages by strong groups of workers whose employment is assured, while weak groups are forced to bear the unemployment burden. Alternatively, if some groups are unsure whether their readiness to accept a wage reduction will be followed by other groups as well, they might prefer a general price inflation which will improve their wages relative to others'. Price-updating costs under mono-

polistic competition, price staggering (difficulties in timely and coordinated price adjustments) and price inertia (a vertical chain-reaction of price increases, from the basic raw material suppliers to the final good) also enhance non-neutrality.

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TAL SADEH

disguised unemployment

The term 'disguised unemployment' originated in 1954 with Arthur Lewis' (1954) pathbreaking work on surplus labour in developing economies. Over time, the term has been extended and applied to certain types of unemployment in the industrial countries. Formally, disguised unemployment refers to a situation in which a worker's wage exceeds his marginal product. In general terms, disguised unemployment of a factor of production occurs when that factor is not used effectively (efficiently). By this definition, unemployment of not only labour but also of other factors of production stems from poor organization or entrepreneurial abilities of firms or employers. Theoretically, by examining how efficient the firm is in using its inputs, given the technology, we should be able to determine whether there is any disguised unemployment at the firm level. While seemingly straightforward, the actual measurement of disguised unemployment is extremely difficult, leading many economists to

question published estimates and even the usefulness of the concept.

In a looser sense, the term is simply associated with a situation where workers use less than their full capabilities. There may be self-employed workers who could readily perform more work than that for which they find customers, wage workers employed for only short working weeks who would like longer ones, and both self-employed and wage workers who are capable of doing more productive work than they are at the moment. The two types of less than full employment are called 'underemployment', and employment at less than full capability is called 'disguised unemployment'.

Reference

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ROBERT LOONEY

disintermediation

How enterprises raise CAPITAL is undergoing a slow but profound transformation. This 'disintermediation' process involves a change in function for traditional agents of INTERMEDIATION, such as banks. Instead of playing the role of middle-man and absorbing RISK, banks are increasingly trading on their own account and wholesale borrowers are obtaining their financing from SECURITIES markets. GLOBALIZATION is promoting this process, as it places pressure on costs, including the interest cost of debt. Without an intermediary, financial markets are potentially less costly. However, disintermediated markets generate an information problem, in that investors do not know whether they can trust borrowers. CREDIT RATING agencies become increasingly important in substituting for TRUST. Disintermediation is most advanced in US markets, but is

disorganized capitalism

increasingly seen as the institutional solution to financial volatility in emerging markets.

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TIMOTHY J. SINCLAIR

disorganized capitalism

The notion of organized capitalism dates back to RUDOLF HILFERDING and was particularly developed by Jurgen Kocka and several other contemporary social historians. For these writers, organized capitalism begins in most countries in the final decades of the nineteenth century as a consequence of the downward phase of the Kondratieff long wave (see KONDRATIEFF WAVES; LONG CYCLES) that began in the mid-1870s. Following this approach, Scott Lash and John Urry (1987) contend that organized capitalism, as foreseen by KARL MARX and Friedrich Engels, consists of the following interrelated features:

- 1 The concentration and centralization of industrial, banking and commercial capital, as markets became progressively regulated; in comparison to the preceding epoch of liberal capitalism, special growth in producers' goods industries; the interconnection of banks and industry; the proliferation of CARTELS.
- 2 The growth of the separation of ownership from control, with the bureaucratization of control and the elaboration of complex managerial hierarchies.
- 3 The growth of new sectors of managerial/scientific/technological intelligentsia and of a bureaucratically employed middle class.
- 4 The growth of collective organizations in the labour market, particularly of regionally and then nationally organized TRADE UNIONS and of employers' associations, nationally organized professions and so on.
- 5 The increasing inter-articulation between

the state and the large MONOPOLIES, and between collective organizations and the state (as the latter increasingly intervenes in social conflicts); development of class-specific WELFARE STATE legislation.

- 6 The expansion of empires and the control of markets and production overseas.
- 7 Changes in politics and the state, including an increasing number and size of state bureaucracies, the incorporation of various social categories into the national political arena, the increased representation of diverse interests in and through the state, and the transformation of administration from merely keeping order to the attainment of various goals and national objectives.
- 8 Various ideological changes concerning the role of technical rationality and the glorification of science.
- 9 The concentration of industrial capitalist relations within relatively few industrial sectors and within a small number of centrally significant nation-states.
- 10 The development of extractive/manufacturing industry as the dominant sector, with a relatively large number of workers employed in that sector.
- 11 The concentration of different industries within different regions, so that there are clearly identifiable regional economies based on a handful of centrally significant extractive/manufacturing industries.
- 12 The growth of numbers employed in most plants as the ECONOMIES OF SCALE dictate growth and expansion within each unit of production.
- 13 The growth and increased importance of very large industrial cities which dominate particular regions through the provision of centralized services (especially commercial and financial services).
- 14 A cultural-ideological configuration that can be termed 'modernism', embracing aesthetic modernism and NATIONALISM.

Scholars, such as Lash and Urry, who stress the development of disorganized capitalism contend that the era of organized capitalism has, in certain societies, come to an end and

that there is a set of tremendously significant transformations which have recently been literally disorganizing contemporary capitalist societies - transformations of time and space, economy and culture, which disrupt and dislocate the patterns that Marx, Engels and others anticipated. Proponents of the notion of disorganized capitalism claim that organized capitalism is - albeit sporadically and unevenly - coming to an end and that societies are moving into an era of disorganized capitalism. In this sense, they part company with Marxists who generally contend that we are living in an increasingly organized society.

With these points in mind, disorganized capitalism refers to the following environment:

- 1 The growth of a world market, combined with the increasing scale of industrial, banking and commercial enterprises, means that national markets have become less regulated by nation-based corporations. From the point of view of national markets, there has been an effective deconcentration of capital. This tendency has been complemented by the nearly universal decline of cartels. Such deconcentration has been aided by the general decline of **TARIFFS** and the encouragement by states, particularly the US, to increase the scale of external activity of large corporations. In many countries there is a growing separation of banks from industry.
- 2 The continued expansion of the number of white-collar workers and particularly of a distinctive service class (of managers, professionals, educators, scientists and so on) which is an effect of organized capitalism, becomes an increasingly significant element in the subsequent disorganization of modern capitalism. This results both from the development of an education-based stratification system, which fosters individual achievement and mobility, and the growth of **NEW SOCIAL MOVEMENTS** (the students', anti-nuclear, ecological and women's movements, for example) which increasingly draw energy and personnel away from class politics.
- 3 Decline in the absolute and relative size of the core working class - that is, manual workers in manufacturing industry (see **CLASS, WORKING**) - as economies undergo **DEINDUSTRIALIZATION**.
- 4 Decline in the importance and effectiveness of national-level collective bargaining procedures in industrial relations and the growth of company- and plant-level bargaining. This accompanies an important shift from inflexible to flexible forms of work organization.
- 5 Increasing independence of large monopolies from direct control and **REGULATION** by individual nation-states; the breakdown of most neo-corporatist forms of state regulation of wage bargaining, planning and so on, and increasing contradiction between the state and capital (see **FISCAL CRISIS**); development of universalistic welfare-state legislation and subsequent challenges from left and right to the centralized welfare state.
- 6 The spread of capitalism into most **THIRD WORLD** countries, which has involved increased competition in many of the basic extractive/manufacturing industries (such as steel, coal, oil, heavy industry, car-manufacturing) and the export of jobs of part of the **FIRST WORLD** proletariat. This in turn has shifted the industrial/occupational structure of First World economies towards service industries and occupations.
- 7 The decline of the salience and class character of political parties. There is a very significant decline in the class vote and a more general increase in broader-based parties, reflecting the decline in the degree to which national parties simply represent class interests.
- 8 An increase in cultural fragmentation and pluralism, resulting both from the expansion of leisure time and the development of new political/cultural forms since the 1960s.
- 9 A considerable expansion in the number of nation-states implicated in capitalist production and the large expansion in the number of sectors organized on the basis of capitalist relations of production.

disproportionality

- 10 Decline in the absolute and relative numbers employed in extractive/manufacturing industries and in the significance of those sectors for the organization of modern capitalist societies. Increased importance of service industries for the structuring of social relations (smaller plants, more flexible labour processes, increased feminization and so on).
- 11 The overlapping effect of new forms of the spatial division of labour has weakened the degree to which industries are concentrated within different regions. To a marked extent there are no longer regional economies in which social and political relations are formed or shaped by a handful of significant central extractive/manufacturing industries.
- 12 Decline in average plant size because of shifts in industrial structure; substantial labour-saving capital investment; the hiving-off of various subcontracted activities; the export of labour-intensive activities to world market factories in the Third World and to rural sites in the First World.
- 13 Industrial cities begin to decline in size and in their domination of regions. This is reflected in the industrial and population collapse of so-called inner cities, the increase in population of smaller towns and more generally of semi-rural areas, the movement away from older industrial areas. Cities also become less centrally implicated in the circuits of capital and become progressively reduced to the status of alternative pools of labour power.
- 14 The appearance and mass distribution of a cultural ideological configuration of POST-MODERNISM: this affects high culture, popular culture and the symbols and discourse of everyday life.

See also:

Fordism, crisis of; globalization; world city

Reference and further reading

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ROBERT LOONEY

disproportionality

'Disproportionality' refers to the effects of maladjustment between the two major aggregate sectors of production, those of investment goods and consumer goods. Especially when the economy moves to a higher rate of growth, partial maladjustments may multiply into general OVERPRODUCTION. Disproportionality theorists see these maladjustment processes as normal and inherently linked to capitalist economies; thus disproportionality is, in fact, the antithesis of the equilibrium that orthodox economics conceives as normal. The concept of disproportionality in general originates from KARL MARX; Tugan-Baranowski turned it into a theory of the BUSINESS CYCLE.

In the last part of the second volume of *Capital*, published in 1885, Marx presented a 'reproduction schema' of the capitalist economy. In modern terms, it would be called a dynamic two-sector macro-economic model, with the first sector producing means of production (investment goods) and the second sector producing consumer goods. Marx was, in fact, the first economist to develop such a model. On the basis of this schema, he was able to specify a number of dynamic interconnections in the functioning of the capitalist economy. Particularly, he showed that in the

context of economic growth, proportionality, or balance, between the two major sectors of the economy is most unlikely. In other words, disproportional or disequilibrium growth, together with its potentialities for economic crisis, is the normal case. Over fifty years later, Harrod and Domar confirmed this result on the basis of their famous 'knife-edge' models of economic growth (see HARROD DOMAR GROWTH MODEL). Empirically, the schema may explain the extreme volatilities of investment (capital formation) that we perceive today.

Marx's schema of reproduction played an important role in the development of (early) Marxian theory, particularly in the field of economic cycles (for example, in the works of Bauer, Grossman and LUXEMBURG). But the schema also influenced a type of non-Marxian economics of the cycle in the early twentieth century, mainly through the work of Tugan-Baranowski.

Whereas for Marx the schema provided merely the background work for setting out his theory of capitalist technical development and recurrent economic crisis (which appears in the third volume of *Capital*), Tugan-Baranowski developed Marx's disproportionality concept into the main explanation of the cycle. He showed in detail how, due to the 'real' and monetary interdependencies of the capitalist system, partial overproductions develop into general overproduction, the development of such disproportionality being characteristic for the boom which at its height turns into crisis. Processes developing in the ensuing recession, however, restore proportionality and lay the foundation for a new upturn, and so on.

Direct or indirect traces of Tugan-Baranowski's disproportionality theory of the cycle can be found in the work of important theorists of the business cycle, such as Spiethoff, Cassel, Aftalion, W. Mitchell. SCHUMPETER and KEYNES (see Reijnders, 1998).

See also:

underconsumption

Reference and further reading

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GEERT REUTEN

distribution of income

The distribution of national income is described in two ways: the 'functional' distribution of factor shares to the owners of land, labour and capital, and the 'size' distribution of personal income to individuals. NEO-CLASSICAL ECONOMICS explains the functional distribution of income by the contributions to production of each of the factors of production: land rent reflects the marginal product of land, wages reflect the marginal product of labour, and interest and profits reflect the marginal product of financial and real capital. The marginal product of a factor is the additional product resulting from the employment of one more unit. Under assumptions of

competitive PROFIT MAXIMIZATION, the prices firms pay to the owners of factors should measure the market value of their marginal products. The prices of the factors of production and the distribution of factor ownership (FACTOR ENDOWMENTS) across individuals should then explain the size distribution of personal income to individuals.

Many of the early classical economists, such as DAVID RICARDO, and modern heterodox economists observe that social POWER, market imperfections and institutions can also affect factor prices and the distribution of income (see NEO-CLASSICAL ECONOMICS, CRITIQUE OF). For example, monopsonistic firms (see MONOPSONY) might be able to pay lower wages than firms under competitive conditions, owners of MONOPOLIES might receive higher rates of return on their capital, unions might successfully raise their members' wages and the state might intervene in markets to distort factor prices.

The distribution of income is thought to influence the macro-economic behaviour of economies, especially INVESTMENT and the rate of ECONOMIC GROWTH. Too much inequality results in relative poverty, which may discourage economic growth by restricting demand for goods; too equal a distribution may reduce the factor share of profits from which to finance investment. Measures of the degree of inequality commonly used include the GINI COEFFICIENT and the LORENZ CURVE.

See also:

endogenous growth theory; equalization of returns to factors of production

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CHRISTOPHER J. NIGGLE

diversification

The term 'diversification' normally refers to exports, and specifically to policies aiming to reduce the DEPENDENCE on a limited number of commodities that may be subject to price and volume fluctuations or secular declines. Another objective is to expand opportunities for the export sector and create possibilities for backward and forward linkages to domestic inputs and services. Thus, through diversification, a country may attain three linked objectives: stabilizing earnings, expanding revenues and retaining value-added. A related objective is the reduction of the dependence on one, or a few, geographical destinations. The economics literature distinguishes between horizontal diversification (through which new opportunities are sought for new products within the same sector) and vertical or diagonal diversification (into processing of domestic or imported inputs). Vertical diversification entails a shift from one sector to another, and generally from the primary to the secondary and tertiary sectors. Through horizontal diversification, a country can reduce the variability of its earnings because downturns in some commodity markets may be counterbalanced by upturns in others. The instability for any group of commodities tends to be significantly lower than that for any of its constituents, indicating that price and volume stability gains are attainable from diversification. Through vertical or diagonal diversification, forward and backward linkages are encouraged, as the output of one activity becomes the input of another, thus upgrading the value-added produced locally. Diversification also enhances the creation of dynamic or secondary effects, since knowledge and experience gained from one sector, coupled with some advantages deriving from ECONOMIES OF SCALE, tend to benefit others in an economy. Therefore, trade diversifications can directly contribute to an acceleration of the growth process.

See also:

geographical concentration of exports

Further reading

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LUCA MONGE ROFFARELLO

division of labour

The division between tasks in any particular factory or enterprise is usually referred to as the 'technical division of labour' (see **DIVISION OF LABOUR, TECHNICAL**), while the allocation of different tasks throughout society is termed the 'social division of labour'. This second division may itself be patterned by geography, leading to a complementary 'spatial division of labour', based on historic regional specialization (Sheffield steel). clustering of similar companies (Silicon Valley) or links to particular **FACTOR ENDOWMENTS** (materials available for mining). A further division can be identified between the conception and execution of a particular task. Management allocates labour to specific jobs, but the control of the overall process is separated from knowledge of its specific parts.

ADAM SMITH suggested that the division of labour had a beneficial effect on productivity for three main reasons: (1) it focuses individuals on particular skills and improves dexterity in those tasks; (2) by standardizing tasks and allowing concentration on a single one, flow is enhanced as individual workers do not continually change their activities or tools; (3) specialization expands the possibility for mechanization and automation. Though the technical division of labour within an enterprise enhances productivity or **EFFICIENCY**, the ability to define what sorts of efficiency should be promoted is crucial to the character of any

particular division of labour (Rueschemeyer, 1986).

For **KARL MARX**, the technical and social division of labour constantly interact under **CAPITALISM**. Factory working prompted the centralization of tasks previously subject to the social division of labour. Different occupations and skills were brought together to form new industries and were subsumed into a technical division of labour governed by the factory owner. However, as tasks became increasingly specialized or new processes were developed, capitalists also recognized that **ECONOMIES OF SCALE** would arise from offering a particular stage of the manufacturing process to more than one enterprise. Thus, dynamics within the technical division allow the development of new social divisions of labour. The division of labour is also reliant on the institution of **PROPERTY RIGHTS**, which allow the **ALIENATION** of labour from its product in the technical division and ensure market exchange across the social division can take place.

At the international level, the identification of the importance of the division of labour owes much to the writings of **DAVID RICARDO**. He argued that, as different countries had different **COMPARATIVE ADVANTAGES** regarding production, some could produce certain products more cheaply than others and therefore specialization mediated through international trade was economically beneficial. In the 1970s, however, this assumption was criticized by those who identified a problem of **UNEQUAL EXCHANGE** between the developed nations and the poorer parts of the global system. Through international trade and the division of labour, it was claimed, the rich nations stripped the developing world of resources, while profiting from the sale of finished goods.

The social division of labour predates capitalism, in as much as the fruits of others' labours have been obtained through exchange since the earliest societies. Indeed, Emile Durkheim argued that it was social specialization rather than economic organization that produced the division of labour. But under capitalism's commodity production, specialization does not only coordinate social activity

division of labour, international

but stimulates productivity and prompts exchange for profit, not merely social use: economics not social practice primarily shapes the division of labour. Thus analysis of the division of labour reveals important aspects of the character of the global system, from factory to systemic level, and as such is a central analytical concept for international political economy (IPE).

See also:

division of labour, international; division of labour, sexual; labour, international

Reference and further reading

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CHRISTOPHER MAY

division of labour, international

ADAM SMITH introduced the concept of the 'DIVISION OF LABOUR' to refer to the specialization of each *worker* in the performance of a particular task within the process of producing a single good. In the same way, the 'international division of labour' refers to the specialization of different *countries* in particular processes involved in the production of a particular good. These days, rather than goods being wholly produced in one country, it is more likely that different parts or components have been produced in different geographical locations and the finished product assembled at a plant close to the final market. The automobile industry depicts this quite well. In the

1980s, a Ford Escort assembled in Great Britain or Germany used components and parts produced in no fewer than fifteen other countries. Some of these component suppliers were part of the Ford Motor Group, others were independent suppliers subcontracted by Ford to do so. A similar pattern can be observed in other industries.

Many factors have contributed to this process. Some important changes have taken place in the way in which products are designed. These days, many products are, in essence, assemblies of a large number of relatively standardized components or multi-component goods. By varying the subsets of components, the product can be redesigned with relative ease. Components themselves are likewise essentially multicomponent goods whose design can be readily altered by varying the mix of components used in their production. There is no need for the production of components to take place where the finished good is assembled. Often, it is more efficient to concentrate the production of components on a large scale in highly specialist plants permitting the maximum possible exploitation of ECONOMIES OF SCALE.

Several changes in international production have favoured this extension of the international division of labour. One of these has been the greater ease with which companies can coordinate production over a region or indeed on a global scale in the way described above. Improvements in communications, including cheaper and more convenient air travel and improved telecommunications have been important. The use of new management skills and the spread of management education may also have helped. Another factor has been the big fall in transport costs due to revolutionary changes in methods of transportation, such as containerization in the SHIPPING industry.

Finally, lower TARIFFS as a result of both global trade LIBERALIZATION and increased regional INTEGRATION have facilitated greater specialization. In some countries, the splitting up of the production process and the relocation of particular stages has been positively encouraged by provisions within the tariff schedules of

the countries concerned. In particular, the offshore assembly provisions used by the United States and some West European countries has meant that finished goods that have been assembled in some other country, using components and parts produced in the former country, have been subject to a lower tariff rate than identical goods assembled from components and parts produced elsewhere.

See also:

component trade; vertical integration

Further reading

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NIGEL GRIMWADE

division of labour, sexual

The sexual division of labour relegates women to a dual form of **EXPLOITATION**. One facet is the fact that the overwhelming majority of unpaid work needed to maintain a household and care for children is performed by women. The other facet is apparent where women have gained access to waged work: their remuneration is generally less than that of men for the same work, while they tend to be concentrated in less prestigious occupations. In households where women do not perform waged labour, there is in effect a hidden tax – the wage paid to a male head of household is expected to support an unwaged worker. Where women work out of the household, social and cultural norms often result in a ‘second shift’ being performed by women: namely, the upkeep of the household.

Globally, what has been referred to as the **NEW INTERNATIONAL DIVISION OF LABOUR** (**NIDL**) has seen many women in **LESS-DEVEL-**

OPED COUNTRIES (**LDCs**) become enmeshed in a system of global commodity production. Women are perceived as ideal for light manufacturing and assembly production for their putative ‘nimble fingers’ and docility in the face of exploitation.

See also:

division of labour; feminism; gender

M. SCOTT SOLOMON

division of labour, spatial

Labour forces are divided in a variety of ways: sectorally (according to their ‘product’), technically (according to the tasks undertaken) and culturally (according to the position of various social groups, defined by **GENDER**, **RACE**, religion and so on). Spatial divisions of labour occur because all of these are subject to geographical differentiation: different sectors, different tasks and different cultural groups occupy different locations as part of the process of combined and **UNEVEN DEVELOPMENT**. Such differentiation occurs at a variety of spatial scales – international, regional and inter-urban, for example – and once established forms a palimpsest by which the structuration of new spatial divisions is both enabled and constrained.

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RON JOHNSTON

division of labour, technical

The term ‘technical division of labour’ refers to the division of tasks within the workplace, a consequence of which is usually specialization and simplification of individual jobs carried

Dodge Plan

out by workers. There follow three implications:

- 1 the creation of a bureaucratic system within which roles and responsibilities are fixed,
- 2 linking rates of pay to the completion of specified tasks, and
- 3 curtailment of worker autonomy.

The system requires strict discipline, which can be achieved via one or more of three strategies:

- 1 economic: pricing, pay and accountancy systems,
- 2 embodiment: the use of overseers and managers, and
- 3 physical: linking workers to a production line which can be varied in speed.

See also:

deskilling; Taylorism

ANDY C. PRATT

Dodge Plan

A banker from Detroit, Joseph Dodge designed the deflationary policies introduced in 1949 by the US authorities in occupied Japan. Dodge called for a reduction in the number of Japanese government employees, as well as a reduction in fiscal expenditures. Part of his plan involved stabilizing the yen dollar EXCHANGE RATE, which he pegged at 360 yen to the US dollar. The Dodge Plan (also known as the Dodge Line) rested on one primary goal – to reduce INFLATION. To this end, credit was curtailed without regard to social costs – principally paid for in the form of unemployment. In the short term, inflation was reduced. The long-term effectiveness of Dodge's policies is difficult to determine, because of the Korean War's impact on Japanese ECONOMIC GROWTH.

JONATHAN R. STRAND

DOLLAR, OVERHANG see Bretton Woods system; dollar, US

DOLLAR, SHORTAGE see Bretton Woods system; dollar, US

DOLLAR, SUPREMACY see Bretton Woods system; dollar, US

dollar, US

The dollar, like any currency, performs a number of functions. As a medium of exchange, it is accepted as a means of payment for goods and services; as a unit of account, it is used to value goods, services and assets, and as a store of value, it is a way in which to hold wealth. Since the end of World War II, however, the dollar's most important function has been as the world's key currency.

Although the dollar first emerged as a major international currency at the end of World War I, it was the end of World War II that signalled the beginning of the dollar dominance that has characterized the post-1945 period. Though gold was the official reserve asset of the international monetary system established at Bretton Woods in 1944 (see BRETTON WOODS SYSTEM), it was the dollar that was the true reserve asset of this arrangement. With the end of the war it became obvious how strong the US economy was in comparison to those of the other industrialized countries. Unable to recover unaided from the damage that had been wreaked on their economies by the war, Japan and the countries of Western Europe required the economic support of the United States in order to rebuild. Moreover, the weakness of the British economy meant that the pound sterling was no longer able to serve as the primary world currency as it had prior to World War II. The only currency strong enough to be used to meet the increasing need for international liquidity was the US dollar.

Nevertheless, there was one difficulty in assuming at this point that the dollar would indeed become the world's key currency. Not

only was the United States running an enormous trading surplus, but also its reserves were large and continuing to rise. There was thus a significant dollar shortage. For the dollar to take on its role of guardian of international liquidity what was needed instead was a BALANCE OF PAYMENTS deficit. Thus, for just over a decade from 1947 until 1958, the United States encouraged – through aid programmes, such as the MARSHALL PLAN and Truman Plan, and through military expenditure outside the United States – the outflow of dollars that provided liquidity for the international economy. In return, other countries measured their economic recovery in terms of their ability to earn dollars through improving trade balances. Hence, the dollar became the world's key currency and the United States became the world's central banker, issuing dollars for the benefit of maintaining the stability of the international monetary system.

The entire economic foundation of the above system was the level of confidence in which the US dollar was held. Such confidence had its base in the relative strength of the US economy, in the existence of large US gold reserves and in the US government's commitment to convert dollars into gold. Yet, paradoxically, the whole system was reliant on a process that eventually undermined that very confidence – the continual flow of dollars out of the United States. For if the balance-of-payments deficit continued, and if the amount of dollars held abroad were to become too large in relation to the United States' gold reserves, then confidence in the dollar – and thus in the entire system – would be under threat. By 1960, just such a scenario had occurred – the amount of dollars held abroad exceeded US gold reserves. With the US deficit out of control, the first run on the dollar occurred in November 1960, with speculators converting dollars into gold. This event signalled the end of American unilateral management of the international economy and the beginning of a series of negotiations aimed at establishing a substitute source of liquidity growth in order to reduce the international economy's reliance on

dollar deficits. The latter were conducted between ten industrial countries – the so-called GROUP OF 10 (G-10) – and the negotiations resulted in the creation of SPECIAL DRAWING RIGHTS (SDRs) which, governments felt, would successfully avert any future threat of world liquidity shortage. Finally, the United States adopted, as an interim measure, controls on capital flows in order to attempt to improve the US balance-of-payments position and thus re-establish confidence in the dollar. Despite this, the United States maintained its expansionary economic policy, notwithstanding the presence of increasing balance-of-payments difficulties, an action that was to have a significant impact on the Bretton Woods system.

At its heart, the Bretton Woods system rested on one simple assumption – that economic policy in the United States would be stabilizing. Thus, for a long time, the United States was able to operate from a position of relative economic autonomy. US national economic policy was neither influenced by the international position of the dollar or by monetary interdependence between the economies of the industrialized states. Hence, large capital flows had much less impact upon the huge US economy than on the other, smaller industrialized economies. Nevertheless, the end of US unilateral economic management signalled the beginning of the US economy becoming constrained by the international monetary system. By the late 1960s, the dollar was overvalued, partly because of INFLATION induced by expenditures on the Vietnam War and partly because other countries had altered their exchange rates to account for inflation (see EXCHANGE RATE), even though the values of the dollar had not been altered. This overvalued dollar contributed to large investment flows and led to declining exports and increasing imports, which had an adverse impact on domestic economic performance. The solution for any country – apart from the United States – in this position would have been to devalue the currency or deflate the economy to establish a competitive trade position. Neither was politically attractive.

Instead, after a period of 'benign neglect' – during which the United States, among other things, followed its domestic policies regardless of their international consequences – the United States unilaterally devalued the dollar against gold in August 1971, thus ending the system established at Bretton Woods. By March 1973, after attempts to rectify the situation with the Smithsonian Agreement of December 1971, all of the major industrialized countries had given up the effort to keep their currencies pegged to the dollar. The dollar, along with all of the other industrialized countries, was now part of a FLOATING EXCHANGE RATE system.

Given the difficulties experienced by the industrialized countries in the years preceding this shift to floating exchange rates, it is perhaps surprising that the demand for foreign exchange reserves, and for the dollar in particular, has remained high. Indeed, throughout the 1970s and 1980s, foreign exchange comprised almost 90 per cent of official reserves excluding gold, and the dollar accounted for an average of 70 per cent of these. Nevertheless, the fraction of reserves held as dollars does fluctuate, depending on whether the value of the dollar is high or low. For example, a strong dollar has significant advantages for other countries – such as improved trading prospects for firms exporting to the United States – as well as disadvantages – such as, in the short term, having to pay higher prices for imported goods. Indeed, over the years, variability in the value of the dollar has been blamed, for example, for increased protectionism, variability in the world price-level and as being an impetus towards inflation. In general, then, countries prefer the value of the dollar to remain stable. This is one of the reasons why the industrialized countries have, over the years, attempted to stabilize the dollar within the framework of international agreement. Thus, for example, among the GROUP OF 7 (G-7) countries, the mechanisms for monetary cooperation have been progressively strengthened since the PLAZA ACCORD of September 1985. The latter officially committed participants to a coordinated realign-

ment of exchange rates, the result of which, initially, was a fall in the value of the dollar followed by its subsequent stabilization. A significant underlying source of such currency fluctuations was the changing nature of world capital-markets, which led to an increase in CAPITAL MOBILITY. The value of the exchange rate thus became increasingly dependent on whatever might cause those who controlled capital to shift funds from one currency to another. Thus, for example, when a major country like the United States pursued policies perceived by the markets as inflationary (that is, likely to reduce the currency's value and hence the real return on dollar assets), the dollar's value plummeted.

However, as demonstrated by the dollar's behaviour in the 1980s, it was just as likely that the opposite would happen. With large budget deficits that needed to be financed, the United States saw itself in desperate need of foreign funds. Indeed, over the years the United States has used the dominant role of the dollar to finance its deficits through foreign capital inflows. In the 1980s, the amount of such financing dwarfed that of previous years. Real interest rates were high and, as a result, foreign money flowed in and drove up the value of the dollar. US producers of traded goods found their competitive position significantly undermined as exports stagnated and imports swelled. The US dependence on such capital inflows posed a serious threat to the dollar, which remained the basis of the international monetary system. The only thing that could be done to halt this whole process was to stabilize the exchange rate – just the issue with which the G-7 were concerned in the Plaza Accord, and later in the LOUVRE ACCORD.

Despite such challenges to the credibility of the dollar's role, as well as some dissatisfaction abroad with US economic policies – a factor that demonstrates the conflict that is inherent in the dual role that the dollar has as both the domestic currency of the United States and the key currency of the international financial system – the US dollar survives in its dominant position. It has done this despite the general antipathy that was felt towards the dollar when

it was seen as excessively weak as in the late 1970s or as excessively strong as in the first half of the 1980s. As was the case in the Bretton Woods system, the size of the US economy and its highly developed system of financial markets, coupled with the political stability of the US government, make it still both desirable and feasible to use the dollar in international transactions. Indeed, the US government largely continues to support the dollar's role, while other countries with strong economies and stable political systems have been hesitant to allow their currencies to play a central international role. There has been, nevertheless, a shift away from the dollar as the exclusive reserve and transaction currency. The question is whether or not this shift will ever be large enough for it to be said that another currency has assumed the role taken on by the US dollar in the post-1945 period.

See also:

fiscal policy; International Monetary Fund (IMF); monetary policies

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ALISON M.S. WATSON

domestic resource cost (DRC)

The domestic resource-cost (DRC) coefficient of a commodity compares the opportunity-cost in border prices of the primary factors (land, labour and capital) used in the production of that commodity with value-added in border prices. The coefficient shows the border-priced value of the resources in their best alternative use per unit of border-priced return from the resources in their existing use. If the coefficient exceeds unity, it can be concluded that in principle the resources could be put to better use in an alternative activity, while if the coefficient is less than one, resources are being used relatively efficiently.

The DRC ratio can also be thought of as indicating the relative COMPARATIVE ADVANTAGES of competing activities. If a product is found to have a DRC of one, then it takes a dollar's worth of resources to produce output that could be purchased internationally for a dollar. Consequently, DRC values less than one identify activities in which the country in question appears to have an international comparative advantage, while those in excess of one can be interpreted as indicating comparative disadvantage.

It should be noted that the estimates of DRC are necessarily tentative, because a number of judgmental assumptions are necessary to value products at world prices, including several arising from the existence of non-traded goods and quality differences. At a more fundamental level, DRCs are based on the assumption of a

double movement

fixed-coefficient technology and do not consider the possibility of substitution.

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ROBERT LOONEY

double movement

KARL POLANYI observed that every economy is socially embedded. When the attempt was made under nineteenth-century LAISSEZ-FAIRE to allow the market to be self-regulating, or 'disembedded', society protected itself. This 'double movement', in which the expansion of the market was countered by society, Polanyi wrote:

can be personified as the action of two organizing principles in society, each of them setting itself specific institutional aims ... The one was the principle of economic liberalism, aiming at the establishment of a self-regulating market, relying on the support of the trading classes ... the other was the principle of social protection aiming at the conservation of man and nature ...

(Polanyi. 1944: 131)

Liberals called this counter-movement protectionism when it restricted trade, but they were less scornful of its other manifestation in nineteenth-century social legislation (ibid.: 144). Polanyi used the double movement, rather than class conflict, as an explanation of institutional change leading to the collapse

of the nineteenth-century order in two world wars. Recently, other scholars have used the concept to explore transformations in the post-war order – most notably Ruggie (1998), in his concept of EMBEDDED LIBERALISM – and the social response to GLOBALIZATION.

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ROBERT WOLFE

double taxation

Double taxation can occur when two governments claim jurisdiction to tax the same part of the income of a transnational taxpayer, often a MULTINATIONAL CORPORATION (MNC). Governments have sought to reduce double taxation in order to promote international investment by negotiating bilateral tax treaties (most based on an ORGANISATION FOR ECONOMIC CO-OPERATION AND DEVELOPMENT (OECD) model) that specify taxing rights of home and host countries and create a mechanism (the mutual agreement procedure) for resolving specific disputes. The principles incorporated in these treaties – that taxation should be based on separate national accounts prepared by corporations for their operations in each country, with prices for intra-firm transactions to be set in accordance with arm's-length prices – also provide opportunities for MNCs to use TRANSFER PRICING and other income-shifting strategies to reduce the profits they declare in high-tax countries and impede efforts to introduce unitary taxation of the global income and profits of MNCs.

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MICHAEL C. WEBB

DOUBLE-TAXATION TREATIES *see*
bilateral dual-taxation treaties

dual economy, theory of

In many countries, a modern commercialized industrial sector has developed alongside a traditional subsistence agricultural sector, resulting in what is termed a 'dual economy'. This dualistic structure embraces four key elements:

- 1 different sets of conditions (one of which can, in some meaningful sense, be described as 'superior' and the other as 'inferior') coexist in a given space at the same time;
- 2 this coexistence is chronic and not merely transitional – that is, it is not simply due to a necessary gradualism, creating time lags in the displacement of the superior element by the inferior element;
- 3 the degrees of superiority or inferiority show no signs of rapidly diminishing – they may be constant or even increasing;
- 4 the interrelations between the superior and inferior elements or the lack of interrelations between them are such that the existence of the superior element does not do much to pull up the inferior element (known as a 'weak spread') or may even positively serve to pull it down ('backwash').

(Singer, 1970)

When a dual economy exists, the ultimate question for the country's future development is how the modern exchange sector is to expand while the indigenous sector contracts. Several theories of dualism have been put forth to formalize mechanisms facilitating the elimination of a dualistic structure.

In his classical model of the dual economy,

W.A. Lewis (1954) established a link between cheap surplus labour in agriculture and the level of industrial wages through the operation of the labour market. Low nominal wages in industry, in turn induce high rates of investment and growth. Assuming, by contrast, full employment, Dale Jorgenson (1961) showed that the possibility of extracting labour from agriculture for industrial employment, without putting upward pressure on the price of food and raising nominal wages for industry, required technological change in agriculture to increase the productivity of labour in that sector. These two features of industrialization in the less-developed economy – surplus labour and the role of technological change in agriculture – were brought together in dual economy models developed by Ranis and Fei (1961) and Lele and Mellor (1981). In the first model, with surplus labour in agriculture and constant real wages in that sector, nominal wages for industry can be lowered by technological change in agriculture that reduces the price of food. In the second model, surplus labour and a constant real wage apply to the urban informal sector while there is full employment in agriculture. Again, technological change in agriculture helps lower the price of food and the nominal wage for industrial employment.

Other aspects of agriculture's role in dualism – beyond cheap food, low nominal wages for industry and the transfer of domestic agricultural savings – have been used to formulate industrial growth models.

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ROBERT LOONEY

DUAL-GAP ANALYSIS *see* two-gap model

dualism

Dualism refers to the division of an economy into an 'advanced' or 'modern' sector, using modern technology, and a relatively 'backward' sector, in which traditional technology is used. The former has been identified in the development literature of the 1950s and 1960s with the manufacturing industry and the latter with subsistence agriculture. The concept of dualism has been used for the construction of influential models of the development of the economy, particularly that of W. ARTHUR LEWIS, in which the growth of the modern sector propels the development of the economy and draws on a passive, labour-surplus, traditional sector through the labour required for expansion. These models declined in influence in the 1970s and 1980s, as the traditional agricultural sectors in many developing countries showed signs of dynamism with the expansion of the use of high-yielding varieties of crops. However, the concept of a turning point at which surplus labour is finally fully absorbed remains useful.

It is also possible for individual markets to exhibit dualism. For example, labour markets – within an industry and even within an individual firm – can be characterized by some workers who are employed for the long term at relatively high remuneration, while other workers receive low wages and have relatively insecure employment. Financial markets also can be segmented, with much higher interest rates being charged by informal suppliers of

credit to small borrowers with whom banks and other financial institutions will not deal.

See also:

enclaves; informal economy; structuralism

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JOHN THOBURN

dual-use technologies

Dual-use technologies are those inventions with applications for both commercial and military products. Firms may hope to profit from the development and application (commercialization) of dual-use technologies by selling to a wider customer-base than they would reach with market-specific technologies. However, dual-use technologies can be exploited by different firms in different markets, so their benefit is not necessarily an economy of scope (see ECONOMIES OF SCOPE). A specific firm will only benefit from the dual-use applicability of technology if INTELLECTUAL PROPERTY RIGHTS are appropriately defined. Governments often hope to use dual-use technologies to reduce the burden of defence-procurement by sharing development and overhead costs with commercial customers. The commercial value of technologies that spin off from military research may also contribute to productivity growth, at least partially

compensating for the negative impact on economic growth of taxes required to fund defence spending. Yet dual-use technologies are not unambiguously advantageous, because their availability may make it harder to enforce export controls. Dual-use technology may therefore facilitate proliferation of advanced weapons, specifically including the transfer of weapons technology to foreign adversaries.

There is some debate about the frequency with which technological changes have dual-use applications – that is, are dual-use technologies becoming more or less prevalent and why might their rate of appearance be changing? In the nineteenth century, defence plants gained early experience of mass production, and those techniques diffused to commercial businesses. More recently, US competitiveness in high-tech commercial sectors has been attributed to technological spin-offs of the COLD WAR defence programme. The most prevalent allegation is that the commercial jet aircraft industry derived key technology – including nearly the entire design for its first commercial success, the Boeing 707 – from earlier military aeroplanes. Similar points are raised in the computer, communications and other high-tech sectors, although the conventional wisdom holds that the aircraft industry is the archetypal case. But even in many of the widely cited cases of technological spin-offs, including to some extent the case of the 707, all international competitors had access to similar dual-use technologies. Successful dual-use technologies are widely dispersed among competitors by imitation, by subcontracting relationships and by simultaneous invention in multiple countries. Most developed countries fund dual-use research. The argument that the entire aircraft industry benefited from dual-use technology is much stronger than the arguments that particular companies or the firms of particular nations benefited disproportionately.

The conventional wisdom also suggests that dual-use technologies are becoming less common as military research focuses on highly specialized attributes of weapons systems. In addition to this trend, which stems from exogenous strategic pressure, defence-procure-

ment regulations may unnecessarily hamper the rate of dual-use innovation. Military research tends to be a high-cost activity, because protections against waste, fraud and abuse demand exceptionally aggressive monitoring of government contract expenditures. The cost of oversight may spread to a defence contractor's commercial projects through accounting mechanisms for overheads or through the adaptation of corporate culture to the high-cost structure. Commercial firms that might focus research on dual-use technology may be deterred from doing so by this potential cost-escalation.

Leading advocates of defence-acquisition reform emphasize this latter point. A major post-Cold War acquisition reform effort in the United States – the Federal Acquisition Streamlining Act of 1994 – in part targeted dual-use technologies. Intellectual property rules were changed to make it easier for firms to exploit commercial spin-offs of technology developed in defence R&D programmes – internalizing the potential economy of scope and thereby providing an incentive for firms to develop dual-use technologies. Acquisition reform initiatives have also sought to require the government to act more like a business customer, attacking cultural barriers to commercial military integration. A more business-like government customer might help defence firms to prepare for commercial market competition. However, initiatives to run the government like a business have been a dominant feature of defence-acquisition reform efforts for more than fifty years, and they have never had much success. Military customers ultimately have different interests and are served by different core competencies than commercial buyers.

Direct subsidies have also been provided for the application of dual-use technology, notably including the short-lived post-Cold War US Technology Reinvestment Project (TRP). The TRP provided matching funds to joint ventures between the arms industry and commercial firms to facilitate projects marrying defence-developed dual-use technology with commercial marketing know-how. Political support for

dumping

the TRP faltered, because the programme did not rapidly generate concentrations of politically visible employment. There is evidence, however, that some of the joint ventures are continuing, even after the federal government support has evaporated, responding to private profit-incentives associated with dual-use technology. Dual-use technology policy may only have been required to overcome the transaction costs of coordinating the commercial and defence-oriented businesses. Nevertheless, the total dollar volume of dual-use high-tech business still accounts for only a small percentage of economic activity.

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EUGENE GHOLZ

dumping

Dumping is generally understood to be the selling of a good at excessively low prices. More precisely, Article VI of the GENERAL AGREEMENT ON TARIFFS AND TRADE (GATT) defines two distinct types of dumping:

- 1 the export price is lower than the corresponding price in the domestic market of the exporter;
- 2 the export price is lower than the cost of production of the product in question.

Although Article VI does not prohibit dumping, it allows GATT Contracting Parties to impose anti-dumping DUTIES whose magnitude may not exceed the magnitude of dumping or dumping margin. Before imposing anti-dumping duties, a national authority must demonstrate that a product has been dumped and that the dumped imports have caused injury to a domestic industry producing a similar product.

Anti-dumping action is allowed under GATT because dumping is considered to be an unfair trade practice and because it is argued that otherwise cartelized or protected foreign producers would be able to use excessive profits from their home markets to cross-subsidize exports and monopolize other markets as a result. This form of predatory pricing, it is claimed, would eventually reduce the economic welfare of importing countries.

However, opinions differ on how significant in practice these arguments are and whether they reflect the real situation of the many anti-dumping cases every year. As in comparable domestic situations, predatory pricing is frequently alleged but not frequently proven. Moreover, it is not necessarily the case that importing countries are worse off as a result of

dumping. Import-competing industries may be harmed, but the consumers or users of the dumped products get to buy them at lower cost.

The principal controversies about action to counter dumping arise from the practices of the major importing countries. These practices are perceived to be biased against exporters and to allow importing countries to target specific foreign firms that happen to be successful exporters. Normally, GATT requires that any form of trade protection is applied *erga omnes* (that is, against all imports of the same product irrespective of source). By contrast, anti-dumping action (as well as anti-subsidy or countervailing action) may target not only particular countries, but also particular firms within those countries.

In addition to this selectivity, some of the other major problems are the methods of investigation, the items which are included in the calculations of costs, the measurement of the injury to the domestic industry and the duration of the anti-dumping duties. Foreign firms under investigation are given little time (usually thirty days) to respond to detailed questionnaires about their costs, exports and markets. If they fail to respond or to provide all the necessary information, trade authorities may use the 'best available information', which is often provided by the plaintiffs. Cost calculations include unrealistically generous profit provisions or profit margins derived from the accounts of other firms. When prices vary across markets or over time, the derived average prices bear little resemblance to actual prices. The causality between dumped imports and injury to domestic industries is often alleged to be proven by the fact that some of the many industry statistics decline over the reference period. Anti-dumping duties are imposed for a certain period of time, but at the end of that period they may be renewed if there is fear of injury, even if dumping has already ceased.

The Agreement on the Interpretation of Article VI (Anti-Dumping Code) that was concluded at the end of the URUGUAY ROUND of GATT has principally codified the then

prevailing practice, rather than constrained the wide discretion of the trade authorities of the Contracting Parties. The major users of anti-dumping provisions are Australia, Canada, the European Union, the United States and increasingly a number of other countries, such as Brazil, Mexico and Turkey. Despite the severe criticism levelled against most anti-dumping action, reform of anti-dumping policies is unlikely.

PHEDON NICOLAIDES

duopoly

Duopoly is a special case of OLIGOPOLY where there are only two suppliers. Market INTERDEPENDENCE between them is very high, as is the temptation to cooperate, unless checked by governments (as is the case, for example, for some strategic weapons). Despite ideological differences, De Beers' diamond cartel (see CARTELS) and the Soviet Union cooperated duopolistically in the 1980s.

DAVID LAW

duopsony

A 'duopsony' is said to exist when there are only two buyers for a commodity in a particular market (see COMMODITIES). Under such circumstances, there will be a tendency for the buyers to employ less of a factor and/or to pay a lower price for the commodity than in more competitive markets.

JASON P. ABBOTT

Dutch disease

The 'Dutch disease' refers to the potentially adverse effects of a booming export sector on the performance of other exports and of industries competing against imports. These effects work essentially through an appreciation

duties

of the real EXCHANGE RATE caused by the export boom, and are particularly associated with expansions of exports of non-renewable resources, such as oil or metals. The term owes its origins to the problems caused to the Dutch economy by the growth of its exports of natural gas in the 1970s, which were associated with a 30 per cent appreciation of the guilder between 1973 and 1978.

In the case of a less-developed country (LDC) (see DEVELOPING COUNTRIES; LEAST-DEVELOPED COUNTRIES (LLDCs)), the exchange rate appreciation resulting from mineral export expansion reduces the profitability and competitiveness of traditional agricultural exports, and encourages imports of food and raw materials which may compete with domestic production; it also discourages the emergence of manufacturing exports. The expansion of Nigerian oil export earnings in the 1970s illustrates these effects.

The effects are similar whether an export expansion results from new mineral discoveries or from a price boom, as in the case of oil in the 1970s. Dutch disease effects on other *tradables* (that is, on imports and other exports) also could occur in principle as a result of technological innovation in a manufacturing export sector. However, minerals are normally the focus of interest because import-competing and other export activities, once damaged, may be difficult to bring back to life when mineral exports are reduced by resource depletion. Dutch disease effects have been blamed for the accelerated decline of British manufacturing in the early 1980s following the growth of North Sea oil exports.

Dutch disease also has been used to describe the effects on tradables of aid inflows in highly aid-dependent economies such as Uganda.

See also:

deindustrialization

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JOHN THOBURN

duties

There are two principal senses of the term 'duties'. First, 'duties' are taxes charged on imported goods, frequently intended to protect domestic industries. By the end of the twentieth century, these TARIFFS were at one-tenth of the level they were at in the middle of the nineteenth century. Second, 'duties' are moral obligations that individuals or other actors have towards others. Thus one might argue that the wealthy have obligations to the poor not to deprive them of their basic needs, or perhaps that wealthy nations have obligations to provide economic assistance to poor nations.

PAUL G. HARRIS

E

East African Community (EAC)

The East African Community (EAC) was a regional economic grouping of three eastern African countries: Kenya, Tanzania and Uganda. It existed between 1967 and 1977, and comprised a common market, a development bank, and transport, communication and scientific research organizations. In its heyday it was cited as an example of successful regional integration.

The origins of the EAC lay in the common languages Kiswahili and English, and the countries' shared British colonial authority. During the colonial period there existed a common currency board, a CUSTOMS UNION (CU) and a common services organization that operated joint services such as post, telecommunications, railways, harbours and airlines.

With the demise of colonialism, the east African institutions were reformed under the Treaty of East African Cooperation, which established the EAC. The EAC was wracked by tensions caused by the imbalances of benefits from integration, which favoured Kenya, the most industrialized of the states. The treaty tried to address these concerns by shifting the common service headquarters, creating the East African Development Bank (EADB) and instituting the transfer tax system. These initiatives were meant to encourage the redistribution of benefits by encouraging more industrial investment in Tanzania and Uganda. These tensions, along with the coming to power of Idi Amin in Uganda and the ideological differences between 'socialist' Tanzania and 'capitalist' Kenya, led to the break-up of the EAC.

Since 1996, the economic bloc has been

revitalized by the reinvigoration of the EADB, issuance of a common internal passport and the harmonization of trade/tariff policies and monetary regimes.

See also:

common markets

Further reading

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MWANGI WA GTHNJI

East Asian Economic Caucus (EAEC)

In December 1990, Malaysia's Prime Minister Dr Mahathir Mohammad put forward a proposal for an East Asian Economic Grouping at a banquet for his Chinese counterpart Li Peng. Mahathir argued that it was necessary for East Asian countries to protect themselves against rising protectionism in North America and Europe through the formation of an exclusive Asian economic bloc. Initially, Mahathir found little support from Malaysia's regional partners in the ASSOCIATION OF SOUTH-EAST ASIAN NATIONS (ASEAN) and hostility from Japan (who objected to the exclusion of the United States and other Western countries). Undeterred, Mahathir sought the backing of ASEAN and eventually, at a meeting of economic ministers in October 1991, a reformulated proposal for an East

East Asian model

Asian Economic Caucus (EAEC) was agreed upon. Support, however, remained largely superficial with little progress made on how the EAEC would operate or function in practice. In July 1993, ASEAN's foreign ministers agreed (with Malaysia's reluctant support) that the EAEC should operate within the ASIA-PACIFIC ECONOMIC COOPERATION FORUM (APEC), rather than separate from it. Largely because of this decision and the lack of real commitment to EAEC, Mahathir responded by boycotting the 1993 APEC summit in Seattle and continued to maintain that an exclusive East Asian economic bloc was necessary to counter other regional economic groupings. In March 1996, such a grouping was effectively formed when Asian heads of government met their European counterparts at the first Asia Europe Meeting (ASEM) in Bangkok.

See also:

regionalism

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JASON P. ABBOTT

East Asian model

The 'East Asian model' is the conceptual shorthand used to denote attempts to identify a common political economy of institutions and policies in the twenty-three economies of East Asia in order to account for their faster economic growth than all other regions of the world economy during the period from 1965 to 1990. The model has tended to be more narrowly focused on and derived from the

economies of Japan, the 'tiger economies' of South Korea, Hong Kong, Taiwan and Singapore (see *FOUR TIGERS (ASIAN)*), and the newly industrializing economies (NIEs) of South-East Asia – namely, Thailand, Indonesia and Malaysia (World Bank, 1993: 1).

A frequent synonym for the East Asian model has been the 'East Asian miracle', which mistakenly implies that economic performance is something magical which cannot be explained. The vast literature devoted to explanations of East Asian economic performance bears testament both to the fact that it is neither miraculous nor inexplicable, and to the degree of disagreement among commentators about the respective contributions of the state and the market to the East Asian model. Explanations of East Asian economic performance have tended to accord primacy to the role of a DEVELOPMENTAL STATE in promoting high rates of investment, productivity growth and endowment of human capital (for example, Leftwich, 1995). However, since the publication of the World Bank report, *The East Asian Miracle* (1993), a revisionist literature based on neo-classical political economy has developed (see NEO-CLASSICAL ECONOMICS), which has sought to challenge some of the assumptions underlying our understanding of the causes of East Asian economic performance.

The World Bank report contended that approximately two-thirds of the growth of the high-performing Asian economies could be attributed to high rates of investment, in excess of 20 per cent of GDP on average between 1960 and 1990 and incorporating unusually high rates of private investment, combined with high and rising endowment of human capital because of universal primary and secondary education. The remaining growth could be explained by improved productivity, which had grown faster than in many other developing and industrial economies because of the unusual success achieved both in allocation of capital to high-yielding investments and at catching up technologically with more industrialized economies (World Bank, 1993: 8). The World Bank's neo-classical orthodoxy that the East Asian economies 'achieved high growth by getting the basics

right' and that 'industrial policies were largely ineffective' (ibid.: 8, 312) has been criticized, especially by those who attribute a positive role to government in the East Asian model. The very fact that the World Bank acknowledged that 'in most of the East Asian countries, in one form or another, the government intervened – systematically and through multiple channels' (ibid.: 5) has been cited as evidence that the macro-economic 'basics' – investment, education, exports – cannot tell the entire story of the East Asian model and must not be separated from their micro-economic foundations or supporting institutions (Amsden, 1994: 624). Moreover, the World Bank's refutation of the importance of the contribution of industrial policy to economic growth, because 'It is difficult to establish statistical links between growth and a specific intervention' (World Bank, 1993: 6) has also been challenged on the grounds that it is similarly 'impossible to establish links between growth and non-intervention' (Amsden, 1994: 628).

The very notion of an East Asian model has been dismissed by Paul Krugman, who has asserted that

the remarkable record of East Asian growth has been matched by input growth so rapid that Asian economic growth, incredibly, ceases to be a mystery.

(Krugman, 1994: 76)

Alwyn Young has further suggested that the common premise underlying much of the research about the Asian tiger economies – namely, that productivity growth in these economies, especially in their manufacturing sectors, has been extraordinarily high – is 'largely incorrect' (Young, 1995: 671). Indeed, with the exception of Singapore, by post-war standards productivity growth has been neither particularly low nor extraordinarily high. Young's conclusion is therefore that neo-classical growth theory can explain most of the difference between the post-war performance of the Asian tigers and that of other economies. Such scepticism about the importance of the role of the state in promoting East

Asian economic development has been criticized by Dani Rodrik. In particular, Rodrik has rejected Krugman's contention that because East Asian growth is known to have been driven by investment there is then no need for further explanation. On the contrary, the very fact that investment has increased from 10 per cent to 30 per cent of GDP within fifteen years in economies where saving and investment decisions have been made primarily by private households and entrepreneurs, is seen by Rodrik not as grounds for wholesale rejection of the East Asian model but rather for further inquiry into its proximate causes (Rodrik, 1997: 422).

See also:

Asian corporatism (AC); Asian crisis; competitiveness of nations; Confucian model of development; industrial policy

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SIMON LEE

East India Company

First established by royal charter in 1600, the East India Company came to epitomize, for liberals of the late eighteenth and early nineteenth centuries, the corruption that was bound to result from mercantilist transgression of the proper distinctions between public and private affairs, politics and economics (see MERCANTILISM). More recent students of the global economy have sometimes regarded the Company as a forerunner of the modern transnational corporation (TNC) (see MULTINATIONAL CORPORATIONS (MNCs)). Like other regulated or chartered companies, the Company was a 'body politic'. Its prime function was to provide a common political framework for the exploitation by its members of their monopoly of trade between Britain and the East. To this end, it raised armies, waged war in India against European and Asian forces, conquered extensive territories, administered justice and punished interlopers. Unusually, it operated from the start with some element of joint stock, though it was not until 1657 that the growing need to finance fixed assets such as fortifications brought a move from 'terminable' joint-stock financing of individual voyages to a system of permanent joint stock.

Like its Dutch equivalent (the VOC) and the Portuguese *Estado da India*, the Company effectively operated as a sovereign power in Asia. While its authority derived ultimately

from the Crown, it quickly acquired a measure of autonomy. The reigning monarch was refused membership in 1624. Shortly afterwards the Company continued its war against the Dutch even after the Crown had concluded an Anglo-Dutch alliance against France. Once again, after the peace treaty of Aix-la-Chapelle in 1748, fighting continued between Britain and France and their respective local allies in India.

Victory over the Nawab of Bengal and the French at the decisive battle of Plassey in 1757 secured British hegemony in the subcontinent, a position that would endure until independence in 1947. It also brought immense wealth to the servants of the company, much of it ill-gotten. The opulence and corruption of the Company, its exclusion of provincial merchants and its substantial power within Parliament and the City of London produced calls for closer state regulation of its political behaviour, leading to the Regulating Act of 1773 and the 1784 India Bill which, between them, created a system of dual control of Indian affairs by Company and state, implemented by British government appointment of a governor-general, a council and a supreme court. During the closing years of the century, the Company also lost effective control of trade to independent firms acting in breach of the monopoly, thought to have handled as much as three-quarters of trade between India and Europe by the 1780s. The successive withdrawal of the private trading rights of its civil and military servants, and of the general trading monopolies with India (1813) and China (1833), completed the transformation of the Company from quasi-state to quango (quasi-autonomous non-governmental organization) financed largely by taxation. With a reputation further damaged by its central role in the supply of opium to China, the prestige of the Company could not survive the widespread revolt of its troops in 1857. It was suppressed in 1858, when the administration of India passed to Crown officials and Queen Victoria was proclaimed sovereign.

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CHARLES JONES

eco-development

In simple terms, eco-development is a policy for economic development that takes account of environmental limits and is ecologically sound. This concept does not, however, depend on an ideological conception of the relationship between nature and society to achieve an environment-friendly economy. In the 1970s and 1980s, international political development strategies were related to the concept of eco-development.

The term 'eco-development' was coined in the environmental debate in the aftermath of the 1972 United Nations Conference on the Human Environment (see STOCKHOLM CONVENTION), and has now been replaced with the notion of SUSTAINABLE DEVELOPMENT. By contrast with the term 'world conservation strategy' (also an offshoot of Stockholm), eco-development relates to the development debate and can be understood as aiming for a redistribution of wealth as a means of fighting poverty. Although it lacks an ideological basis, eco-development is also not based on some general principle that environmental protection serves everybody's interests and consequently no rethinking of the social and global distribution of resources, wealth and power is necessary. Eco-development, at the global level, aims at a redistribution in favour of the South and of economically disadvantaged regions in general, although how such a transforming development can be facilitated has not been discussed in any detail at either the theoretical or the empirical level.

The basic underlying principle of eco-development is that the solution to environmental problems is connected to developmental problems. However, the exact nature of this

connection and resultant policy aims have not been established by the debate. The concept is mostly based on utopian ecological thinking and cannot be theorized or demonstrated empirically. In spite of this shortcoming, eco-development achieved a certain significance in the 1980s by stressing four elements necessary for environment-friendly development: need orientation, participation, environmental compatibility and self-reliance, as discussed below.

First, in accordance with development concepts of the 1970s, poverty is the central problem for eco-development, with the satisfaction of basic and essential human needs – starting with the needs of the poorest and neediest in society – being the highest priority.

Second, participation in an eco-development strategy is based on a critique of industrial development, since in so-called 'developed' societies the process of economic growth and industrialization has been in the hands of a small elite group with most projects promoted in the pursuit of private profits. Therefore participation has to be understood as part of normative, politically grounded thinking in which democratic norms are prioritized, based on an understanding that social development is increasingly dependent on the support of the majority of the population.

Third, eco-development links two causes of environmental problems: on one hand, there is environmental degradation caused by UNDER-DEVELOPMENT in the South; on the other, there is the degradation caused by overdevelopment in the North. Therefore, eco-development concepts cannot be based on separate social development models for the North and the South that would leave the unequal distribution of wealth between North and South untouched. Underdevelopment and overdevelopment are structurally linked and this interrelationship has to be the starting point for ecological reform of the global political economy.

Finally, the element of self-reliance also finds its roots in the development debates of the 1970s and can be related to the problematique discussed in DEPENDENCY THEORY relating to the dependence of developing countries

on world markets, though not to the debate on import substitution. Rather, the eco-development strategy would aim to include local groups and individuals through project work. The concept of eco-development has been used in individual environmental analyses of development processes and in a multitude of development projects: programmes and projects in the field of rural development in African countries (such as Tanzania and Mozambique), in Asia (India and China) have led to the practical application of the concept, although there is little data on the success or permanence of such projects.

The main weaknesses of the concept of eco-development are:

- 1 Eco-development lacks a social theory basis, though it can be found in political and development strategies or programmes/projects. These projects result in experience which cannot be generalized in grounded theory, being more closely connected to a bottom-up approach in the ecological transformation of society. Therefore, eco-development seems likely to remain a strategy for the informal sector and for rural development.
- 2 The concept of eco-development would be far less neutral if it was integrated into a systemic analysis of global society and the obstacles to ecological transformation. If this was the case, the redistribution of wealth that has been called for would have to be formulated in detail and strategies for its implementation developed.
- 3 Eco-development as a political concept is a state-run and top-down approach, as well as a strategy of basic movements based on projects such as ecological agriculture. The countries whose models of development come closest to eco-development are those in special circumstances or those following individual paths of development: Tanzania, China and Nicaragua, for example.
- 4 Eco-development supports small, ecologically diversified production and property structures based on smallholders, poor and subsistence-oriented farming in the Third

World or on marginal ecological farming in the First World. The small farmer is considered the best subject of eco-development, but – as the concept of eco-development is not historically and sociologically based on the social situation, lifestyle and mode of production, as well as consciousness of the producer – it is sociologically abstract.

Although the approach is neither anti-capitalist nor anti-socialist, eco-development does criticize large-scale production methods, such as those used in industrialized agricultural systems and collective farming arrangements. Eco-development is a local approach and a micro-strategy that has been extended into a global concept. This distinguishes it from the concept of sustainable development, which is a systemic approach (even though it is not explicitly based on systems analysis).

See also:

green movement

GABRIELA KÜTTING

eco-labels

'Eco-labels' are easily identifiable seals on product packaging. They inform consumers about the effect that the production, consumption and waste of products and services have on the environment. They have two objectives: (1) to provide consumers with information about the environmental effects of their consumption with a view to encouraging more environmentally friendly consumption patterns; (2) to encourage governments, firms and other agents to increase environmental standards in general.

The most common eco-labels are Type I labels, which certify a product's environmental standards relative to other products. They are third-party voluntary programmes and usually have governmental support, aiming to certify products and processes on multiple criteria covering the product's entire life-cycle (for

example, the 'Blue Angel' mark in Germany). Type II labels are one-sided informative environmental claims made by manufacturers or distributors. They refer to a specific attribute of a product (for example, such as 'CFC-free').

See also:

chlorofluorocarbons (CFCs)

Further reading

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IBON GALARRAGA
ANIL MAKANDYA

ecological economics

'Ecological economics' can be broadly defined as a reaction against economic theories that assume economies can operate independently of either natural resource constraints or assimilative capacity. A tradition of thought classifiable as ecological economics can be traced back at least to the middle of the last century (see Martinez-Alier, 1990). However, the current movement is founded on concerns from the 1960s and early 1970s for LIMITS TO GROWTH and on the study of the flow of energy and materials through the economy (that is, the laws of thermodynamics). Elements of the modern ecological critique of economics are clearly identifiable in William Kapp's writings on the management of environmental EXTERNALITIES as pervasive social costs and in Nicholas Georgescu-Roegen's many contributions (most notably in his work on the implications of entropy for economics) (see Kapp, 1950; Georgescu-Roegen, 1971). However, expressing such an ecological critique of economics failed to be accompanied by unifying institutions within academia which might have established a new discipline or paradigm.

This changed in the late 1980s and early 1990s with the formation of both associations, such as the International Society for Ecological Economics (ISEE) and the European Society for Ecological Economics (ESEE), and journals, such as *Ecological Economics*.

The ISEE was founded around the idea of uniting two groups of academics coming from narrow methodological backgrounds, ecologists trained in the falsificationist methodology of the natural sciences and neo-classical economists trained in logical positivism. Introducing the first issue of the journal *Ecological Economics*, the editor stated that the subject would extend the overlap between neo-classical environmental economics and ecological impact studies, and encourage new ways of thinking about linkages between ecological and economic systems. This 'ecology and economics' viewpoint regards each discipline as a distinct subject area, with specific types of narrowly defined interaction. Supporters of this perspective reject ecological economics as an alternative paradigm and regard environmental problems as reducible to side constraints on economic activities (facilitating the optimal-control modelling favoured by resource economists). The 'ecology and economics' school of thought is often associated with the expression of a particular set of values and a concentration on the 'objective' science approach to both subjects. Mathematical modelling, then, tends to be favoured over social relevance and socioeconomics.

Meanwhile, ESEE has naturally evolved a socioeconomic perspective, which in many ways reverts to a POLITICAL ECONOMY of the past and draws on heterodox theories. A distinguishing feature of the European movement is the search for cooperation with philosophers, sociologists and psychologists to explore ethical, social and behavioural fundamentals of human well-being. This often contrasts with the position of those who have viewed the subject as linking neo-classical economic and ecological models rather than exploring alternative paradigms. Thus, some researchers who currently subscribe to ecological economics continue to exclusively produce

research results which fit comfortably within neo-classical theory. As a result, confusion has continued in some quarters over defining what the subject involves, although a distinctive literature in ecological economics has been forming around a set of values fundamentally different from neo-classical theory.

Critics of established approaches have been attracted to ecological economics by the potential to explore new paradigms. The unifying theme has been the belief that effective environmental policy formation means the separate study of environmental problems without regard to economics is as misguided as the economic approach excluding the natural science perspective. Thus, the work of some neo-classical environmental economists is commended in terms of identifying problems in the efficient allocation of resources and exposing the fallacy of the assumption that economic systems can be meaningfully studied without regard to natural resources or the environment. However, the full implications of these findings, when taken to their logical conclusion, also is taken to mean that much of neo-classical economics is an impediment to further advancement.

More than merely combining economics with ecology, the movement has begun looking across other subject divides (such as between moral philosophy, social psychology and politics), and recognizing the importance of methodological and value issues: noting, for example, that the moral standing of unborn future generations are inadequately addressed by debates over interest rates and their derivation. Among the core moral concerns are compassion towards disenfranchised humans and addressing distributional inequality. Social and community values are recognized as key to improving human well-being and therefore part of the consideration in addressing environmental problems. Much of ENVIRONMENTALISM is concerned with a sense of community across space and time. An opinion with links to Marxist critiques is that free-market systems educate individuals to act as selfish hedonists and thus create self-perpetuating power structures which reinforce inequality. Thus, ecologi-

cal economics is also interested in exploring alternative institutions and processes (see INSTITUTIONALISM). Such an institutional approach needs to consider how a variety of values can be expressed and how to prevent the loss of values which occurs when they are squeezed to fit within the free-market paradigm. This is leading towards an interest in the development of participatory decision processes and approaches to multi-criteria decision analysis which aims to resolve (rather than solve) environmental conflicts and allow for incommensurability of values.

As a result, the themes of the developing subject area no longer sit comfortably in the mechanistic framework of mainstream economics and the divide between the two seems set to grow. In fact, the neo-classical approach has always been but one type of economics operating within ecological economics. Institutional economics has been exerting its influence and may offer a forum more amenable to many. Marxism and SOCIALISM have also been entering the debate, with authors considering how the environment should be included in their more traditional analyses; one result has been the development of political ecology. As part of the research agenda, the role of science in society is being reassessed with implications for the role of both ecologists and economists in environmental policy formation (see, for example, the work of Silvio Funtowicz and Jerry Ravetz on 'post-normal science' – Funtowicz and Ravetz, 1990).

Currently, there are several contending themes which might define the core of ecological economics, though pulling these together without alienating certain factions will be difficult. Giuseppe Munda (1997) provides a useful summary of some of the key concepts. These are that ecological economics (1) is concerned with the policy consequences of its arguments, (2) openly claims ethical positions rather than neutrality, (3) accepts that values can be disputed and may be incommensurable, (4) recognizes distributional issues as a primary concern and (5) sees the ecological concept of scale as limiting material growth. In addition, he proposes (more contentiously) that the

coevolutionary paradigm, as described by Richard Norgaard (1994), is a potential unifying theme. Evolutionary dynamics emphasize that economic and environmental systems are interacting and changing, often unpredictably, rather than static, and that this implies analysing non-deterministic processes rather than optimal paths to static equilibria. However, the particular interpretation via the coevolutionary paradigm remains more debatable.

Ecological economics is important because it attempts to integrate and synthesize many different disciplinary perspectives. Some consensus exists around the key aspects, which include the recognition of ecosystems' constraints; a concern for equality, fairness, effectiveness and efficiency in economic systems; a regard for the moral standing of others, both within current and across future generations of humans. Other considerations, such as the moral standing of non-humans, are open questions. Consideration of ecology also presents fundamental insights into economics, rather than a few extra constraints. For example, ecosystem change is episodic, rather than continuous and gradual; scaling up from small to large is a non-linear process. Ecosystems may also exhibit multiple equilibria, an absence of equilibria and are destabilized by a range of forces. Ecological economics is now beginning to explore alternative and novel ways of addressing such issues, while combining them into a coherent subject area.

See also:

environment; environmental impact of projects; neo-classical economics, critique of

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CLIVE L. SPASH

Economic and Monetary Union (EMU)

Monetary union is the most far-reaching enterprise that the EUROPEAN UNION (EU) has ever undertaken. The ambition to create a monetary union and one CAPITAL MARKET was present from the very start of the post-war history of European INTEGRATION. Three major attempts in the past illustrate the difficulties in reconciling different ideas and interests in a society of states such as the EU.

Economic and Monetary Union (EMU)

National economies must converge if the transition into a single monetary regime is to be successful (see CONVERGENCE). Whether or not monetary union is beneficial remains a matter of speculation until the experiment has been completed.

A short history

The TREATY OF ROME, establishing the EUROPEAN ECONOMIC COMMUNITY (EEC) in 1957, avoided the subject as too controversial. Member-states retained their powers 'to take the necessary protective measures' in the event of a sudden crisis in their external accounts. But the treaty required that member-states act in the 'common interest' when formulating and executing EXCHANGE RATE policies. This became more problematic as inflation rates edged upwards in the 1960s and the BRETTON WOODS SYSTEM began to unravel.

In 1970, the Werner Plan proposed a three-stage move to monetary union, with a single currency, free capital movements, centralized EEC economic policy-making and a European central bank. Member-state leaders, at their Paris summit in October 1972, envisaged full European economic and monetary union by 1980. Instead, divergent economic policies and performances led the member-states to adopt a FLOATING EXCHANGE RATE regime, in which the smaller countries pegged their currencies to the Deutschmark (DM), and sought to adjust their policies in line with Germany's.

The EUROPEAN MONETARY SYSTEM (EMS), conceived as a Franco-German initiative in April 1978, was launched in March 1979. The EMS effectively created a regional Bretton Woods. Currency fluctuations were restricted within an EXCHANGE RATE MECHANISM (ERM). The EUROPEAN CURRENCY UNIT (ECU), as a weighted basket of member-country currencies, was retained as an indicator of a currency's margin from parity. Participating governments were to contribute one fifth of their gold and US dollar holdings to a European Monetary Cooperation Fund (FECOM). In exchange, they received ECU balances to support EMS parities. A fiscal

transfer mechanism was added to improve intra-EU payments imbalances and to facilitate payments adjustment.

FECOM was indefinitely delayed for a 'more opportune moment' at the European Council meeting at Brussels in December 1980. The ERM became an extended DM-zone, with the BUNDESBANK operating as Europe's *de facto* central bank. In 1987-8, France sought to reconstitute the EMS. The finance ministry proposed a common currency, aimed to have the Bundesbank hold ECUs rather than dollars as counterpart to German external surpluses, and use them to subscribe to French treasury bonds. The German cabinet suggested a single currency, entailing free capital movement, giving priority to price-stability, political independence of the ECB, no inflationary financing of government deficits and a federal political system. The European Council at Hanover in June 1988 created a special committee, chaired by Commission President Jacques Delors and including all EU central-bank governors, to investigate ways of achieving economic and monetary union.

The committee's report in the spring of 1989 reflected its composition. It proposed a programme for the creation of European Monetary Union (EMU) through irrevocably FIXED EXCHANGE RATES, a single European currency, a common monetary policy under the direction of a European central bank and rules to constrain national governments with regard to budgets. The Bundesbank's reticence on the ECU was recorded in the reference to its having 'potential'. The report sketched three stages to monetary union. Capital movements were to be freed on 1 July 1990. The second stage would start at an unspecified date, once a new treaty had established a EUROPEAN CENTRAL BANK (ECB) and precise (but not binding) rules on the size of government deficits. The third stage would start once the mechanisms for the internal market were in place.

The report was endorsed at the Strasbourg European Council in December 1989, as German unification gathered momentum. German unity was completed on 3 October 1990, ahead

of the December general election. Chancellor Kohl supported the Bundesbank's terms, presented to other governments as 'non-negotiable' demands for political union, price stability, completion of the internal market, political independence of the ECB and member banks, and ECB monopoly on all necessary instruments. Prior to union, price levels had to converge on a stable and low norm. There was to be no inflationary financing of government deficits and there were to be binding rules on government spending.

The MAASTRICHT TREATY, signed on 7 February 1992, incorporated a German programme for a single currency. France accepted these terms and the German government signed away the DM. During the transition, member-states were to strive to achieve the convergence criteria, defined in a protocol. These were essentially financial: low inflation, stable interest rates, stable currencies in the ERM, and moderate government deficits and public debt. A European Monetary Institute (EMI) was to be created with responsibility 'to coordinate monetary policies'. Stage Three would start in January 1999. If enough states were not ready by 1996, the EU would decide in 1998 and by majority-vote which countries were prepared. National currencies were to be fixed in price, and the new currency was first to be introduced in 1999 on the wholesale markets, and by 2002 on retail markets.

Public opinion and the Bundesbank were less than enthusiastic about the treaty. World financial markets doubted the credibility of existing exchange rates and challenged them repeatedly in the course of 1992–3. Germany won the support to locate the ECB in Frankfurt, to call the common currency the 'euro' (€) over the French choice of 'ECU', and to introduce a 'stability pact', whereby governments running excessive deficits would be fined. But France continued to champion the ECB's political accountability to the European Council and agreed to tighten joint supervision of exchange rate policies – an 'ERM 2', whereby 'out' currencies would move within the prevailing 15 per cent band in a grid hinged on the euro. The Bundesbank insisted that the

ECB would have no obligation to intervene on behalf of weak currencies: the burden would be on them.

Convergence and an EU monetary regime

Arguments on convergence: The key statement for the proponents of monetary union is that the density of the EU interdependence requires a monetary regime. National governments alone can no longer maintain fixed exchanged rates, discretionary macro-economic policies and freedom of capital movement. They may operate two of the three policies, but not all three together. The least satisfactory combination excludes fixed exchange rates: frequent currency realignments endanger the internal market, as business located in hard currency countries lobby for protection against competition from suppliers located in soft currency countries. Even if fixed exchange rates are included, the rates are reversible, because their very existence implies an escape clause. Exchange rate uncertainty inhibits the growth of intra-EU trade.

The theory of an optimum currency area suggests, by contrast, that the benefits from a common currency should be balanced against the costs of a state not retaining discretion in monetary and exchange rate policy. Many commentators argue that discretion has been lost by governments to global markets. If this were the case, then policy choice would not exist and it would be meaningless to criticize governments for policy failures. Government responsibility for the management of national economies was the central principle of the Bretton Woods accords of 1944. EMU has policy set for the EU as a whole, which may not be compatible with the domestic exigencies of any one member-state. Intra-EU trade is not inhibited by the existence of exchange rates, so much as by the continued use of NON-TARIFF BARRIERS (NTBs).

Mechanics of a stable exchange rate regime: If an exchange rate between two currencies (such as the DM and the French franc) is to be locked-in over time under a fixed-rate regime,

there must be convergence in expected real interest rates – that is, convergence in nominal interest rates and over the longer term in expected rates of inflation. This convergence can be brought about at any rate that is politically acceptable to participating countries. The CREDIBILITY of the exchange rate link in the eyes of the financial markets requires that convergence comes sooner rather than later.

The exchange rate is only one of the many prices, such as wages or interest rates, that governments may be keen to regulate. The central bank may buy or sell its own currency to achieve a particular exchange rate objective and then neutralize the impact of the intervention by means of domestic monetary policies. In such cases, the central bank either gains or loses reserves and the country encounters a BALANCE OF PAYMENTS surplus (undervalued currency) or deficit (overvalued currency). This in turn leads to a change in the central bank's external reserve position, increasing in the former case and being eroded in the latter. The exchange rate between the two currencies becomes incredible to the financial markets, as the deficit country loses external reserves. This process continues until one of two developments occur. The deficit country's reserve holdings or capacity to borrow externally becomes impaired; the surplus country fails to neutralize the expansion of money and credit through monetary policy (see MONETARY POLICIES), risking a general rise in the level of prices (see INFLATION), and decides therefore to end intervention in the markets to keep the currency undervalued. At that point, either the fixed exchange-rate relationship will come apart or the two countries will have to bring domestic inflation and interest rates into alignment, usually under duress.

Convergence under conditions of asymmetry: The convergence story contains lessons about the asymmetrical relationship between Germany and France. Since 1973, Germany, as Europe's key currency country, has looked to its domestic monetary policy in the first instance, while all other countries derive their domestic monetary policies from the fixity of

their exchange rate relative to the key currency. In 1987, the French accepted the liberalization of capital movements. The Banque de France had a choice: (1) to continue to keep domestic interest rates down and end the fixed exchange rate to the DM, or (2) to keep the fixed exchange rate, in which case it had no option but to watch the interest rate rise instantly towards the levels prevailing in Germany.

The inflow of French capital to Germany would also bring German interest rates down, perhaps against the wishes of the Bundesbank. This confronts the Bundesbank with a choice: (1) to keep the DM-FF rate, on condition that the Banque de France sticks to the Bundesbank's priority for tight money, or (2) to unhinge the FF from the DM, freeing German monetary policy from the exchange rate constraint, but leaving the DM directly exposed to the fluctuations of the dollar. The second option is the Bundesbank's favourite and that of a growing lobby of German DM-bondholders, hostile to inflation which devalued their investments, but it has been regularly countered by Germany's equally powerful export lobby, concerned at loss of price competitiveness of their goods on world markets. They preferred the DM to be sheltered from dollar movements in a stable exchange rate regime within the EU.

Preferences and expectations in an asymmetrical relationship: The German population has a 'memory for the future', in that expectations incorporate knowledge about the French (or Italian) inflationary past. Had France (or Italy) been sincere in converting to stability-oriented policies, they would have opted to earn credibility on the international markets by their own exertions. The suspicion remains that France wanted the euro in order to launch an expansionary policy in the EU with like-minded partners. Given its under-utilization of resources, the EU is a prime candidate for a Keynesian capital-spending programme (see KEYNESIAN ECONOMICS). This may appeal to the EU's unemployed, and to EU bondholders on condition that the projects' financing is non-inflationary.

If trust was a fragile plant in the Franco-German relationship in the run-up to EMU, it barely existed (as far as German bondholders were concerned) with regard to Italy as a prospective entrant to the euro in January 1999, on account of Italy's inflationary record. In Italy, such an attitude tended to be seen as an expression of German racial sentiment, illustrating that the technical discourse of EMU also covers ancestral voices in Europe. Yet the German export and unemployed lobbies favoured Italy's early entry, as a floating lira outside the euro could provide Italy's formidable exporters with a major cost-advantage on EU markets. French manufacturers agreed, but Italy in the euro is a valuable companion for France in favour of EU expansionary policies after the euro has been installed.

Credibility and legitimacy: The concept of 'credibility' refers to the rules by which a government agency operates, which prevent the agency from taking inconsistent actions. From a public-policy perspective, charters for 'independence' are insufficient conditions for a central bank's reputation. A central bank is embedded in a network of power relationships with other agencies, political parties and so on. In order to preserve its autonomy, the central bank must maintain an effective coalition to which it can appeal for support when one or other of the players ask it to renege on its reputation or seek to override it. It may not always win the battle. The Bundesbank lost to Chancellor Kohl over the abolition of the DM, but seeks to live by its mandate until its absorption in the ECB.

Credibility also refers to the government agency's reputation for implementing announced policies. A reputation for consistent inconsistency (the analogy of the eternally repentant drunkard) is shaken off with great difficulty. Building a stock of credibility takes time, during which the legitimacy of the new policy may be challenged. Legitimacy of policy is expressed in terms of perceived benefits and costs, now and in the future, among citizens. A stability orientation wins political support in

Germany. In France, the public's prior concern is unemployment. The credibility of the DM-FF exchange rate is thus weakened by the market's knowledge that the legitimacy of the exchange rate is challenged by a section of the French electorate, which equates high unemployment with the import of the Bundesbank's restrictive policies.

Convergence and institutions: The relation of credibility to legitimacy also affects implementation. Commitment to a fixed policy is credible when the state acquires the means to implement it. Acquiring the means is likely to be controversial, since institutions must be adapted:

- 1 The central banks must be able to affect the supply of money and credit in nearly identical ways. This depends on how and why the central bank uses standard monetary policy tools such as open-market purchases or changes in bank reserve requirements, and so on. The choice of such tools is of crucial importance to the financial system and to the structures of corporate governance.
- 2 The charters of the central banks managing a fixed exchange-rate regime have to be similar. How effectively the central bank manages its political autonomy from demands to expand or to contract the supply of money and credit has a great deal to do with what happens to interest rates and exchange rates.
- 3 FISCAL POLICIES must converge, as different tax and spending policies exert different pressures on the demand for money and credit, which in turn places strains on the exchange rate.
- 4 There must be a high degree of political consensus among countries pursuing a fixed exchange-rate regime with regard to monetary, fiscal and labour market policies, as well as on policies on competition, mergers and acquisitions, state aid and so on. The financial and economic policy communities of countries seeking macro-economic convergence have to agree on policy priorities,

implement them with identical success, and enjoy strong support from organized interests and in public opinion.

Monetary union

Monetary union entails some undisputed effects. At its most fundamental level, it eliminates national currencies and exchange rates among the participating countries. As a consequence, it eliminates associated transaction costs, where payments are made between buyers and sellers in two or more currencies. This reinforces a single market for goods and services. Consumers benefit as prices across the EU become more comparable in one currency. Smaller companies, which do not have ready access to hedging facilities on futures markets, will find it easier to service an EU-wide market.

Monetary union makes possible a unified market for money and capital. Companies and investors issue, purchase and sell securities which are no longer subject to foreign-exchange risk. Capital is allocated optimally on an EU-wide basis of the underlying risks and returns. Such a market helps raise the rate of savings and investment, and offers borrowers a lower cost of capital and saves a high rate of return. By continually feeding capital to viable industries and denying it to industries that have lost their competitive advantage at global market prices, a single capital market helps accelerate the rate of TECHNOLOGICAL CHANGE and other determinants of ECONOMIC GROWTH – sometimes called ‘dynamic benefits’ of monetary union. Investors also may request greater accountability of managers, opening up the many secluded corners of corporate governance in the EU.

Monetary union also requires and impels institutional development of financial intermediaries and of corporations. Financial intermediaries compete in a highly liquid and contestable market, transformed by the conversion of national bond and equity markets to euros and by EU legislation on financial services. The scope and volume of transactions is possible on account of an EU-wide financial intermediation infrastructure. EU-wide mar-

kets must be policed by effective competition policies in order to ensure that monopolies or oligopolies (see MONOPOLY; OLIGOPOLY) are not established on a European scale. Investor protection similarly requires the further development of a regulatory regime for all financial institutions. EMU accelerates the denationalization of labour markets with regard to cross-frontier movements, equivalence of training diplomas, transferability of pensions and so on.

Monetary union means a single financial market in which all borrowers except the sovereign (the EU as a whole) must compete on an even footing. The Maastricht Treaty restricts the ECB from financing EU deficits by having its debt monetized (purchased and held by the central bank). Member-states may finance budget deficits of infrastructure development by issuing debt, but this debt competes with all other types of debt in the market. All debt is evaluated in terms of potential default risk, which in turn is reflected in the interest rates. In the case of a profligate member-state government, the bond markets demand prompt corrective action, signalled by interest-rate changes and/or the success or failure of new issues. Monetary union and the absence of national central banks, in short, brings new fiscal policies under significantly greater discipline.

EMU spells only one federal or confederal budget and fiscal policy, with all member-states having to finance any budgetary deficits in the single capital market. Herein lies a major difference with the United States and a central point of controversy over EMU. The US budget provides offsetting expenditures for states which experience a downturn in economic activity. The EU lacks such a facility. There are at least three contending positions: (1) member-states should continue to adapt their own rhythm to ongoing changes in the world economy by retaining discretion over monetary and exchange-rate policy; (2) the EU budget must develop its ‘own resources’ to help offset the costs of local downturns, as is the case in the US, and (3) to the extent that fiscal transfers encourage market adaptation, these can be supplied by national governments.

One-currency and -capital market hold significant implications for industrial and labour market policies as well. First, the fiscal discipline imposed by monetary union restricts the ability of governments to support uncompetitive industries, favouring privatization and winding-down of government subsidies. Second, industrial adjustment to changing competitive conditions may accelerate as the fluidity of capital increases, creating turmoil in labour markets and requiring much greater occupational and locational mobility of the labour force. This is another controversial policy domain. Member-states entered EMU at already high levels of unemployment, due in part to policy failures with regard to labour-market institutions. Under EMU, labour-market policy is invited to accommodate an adjustment process mightily reinforced by a single capital market.

Designing regimes for such an extensive list of policy areas affected by monetary union requires a degree of political integration, whose extent is highly controversial. Given the magnitude of such an agenda, whether monetary union is or is not beneficial remains speculative until the experiment has been made. One view is that EMU will continue to be accompanied by severe political strains within member-states and by tensions between them. The opposite view holds that EMU provides member-states with a common regime and ends the Bundesbank's untenable regional hegemony as Europe's *de facto*, but not *de jure*, central bank.

Until 1990, Germany's major security partner in the context of the COLD WAR was the US. In essence, Germany acquiesced in the dollar's privileges as a reserve and transactions currency because the US was Germany's prime protector in the Cold War. The Bundesbank's counterpart in managing the dollar DM rate was the Federal Reserve, not the Banque de France. Restrictive policies in Germany combined with looser monetary stances in the US tended to overvalue ERM currencies relative to the dollar. During EMU negotiations, France insisted that foreign-exchange policy for the single currency remain in the hands of the Council. Germany wanted the ECB to enjoy a

monopoly over all aspects of monetary policy. Determination of the euro's rate to the dollar is likely to be a central source of tension between the ECB and Council. The euro's exchange rate continues to be of immediate concern to the Commission responsible for the EU's trade relations.

At Maastricht, the EU failed to develop a coherent and effective COMMON FOREIGN AND SECURITY POLICY (CFSP). The task of ensuring Europe's security devolved, by default, to the NORTH ATLANTIC TREATY ORGANIZATION (NATO) and to the US. Yet the EU's move to monetary union created the euro as a potential rival to the dollar, and the euro-capital market is an alternative to the US capital market for investors around the world. A realist might make note of the tension inherent to the EU's situation, whereby the EU continues to be dependent for its security on the US, but mounts a monetary challenge to the dollar.

It is clear that the euro has a long way to go to earn credibility, given that it has no track record and that the EU does not have far-reaching political integration. On the other hand, were the EU not to go through with its most ambitious project to date, it would forego its credibility in the eyes of citizens and of the world financial markets. The markets would never forget that the EU could not live up to its commitment. It is for this reason of credibility that the promoters of EMU state that there can be no turning back, no delay, no postponement.

Further reading

- Kenen, P.B. (1995) *Economic and Monetary Union in Europe: Moving Beyond Maastricht*, Cambridge: Cambridge University Press. Analyses the plan for monetary union in the Treaty and surveys research on the benefits and costs of monetary union.
- Padoa-Schioppa, T. (1994) *The Road to Monetary Union in Europe: The Emperor, the Kings and the Genies*, Oxford: Clarendon Press. Collection of articles and essays covering the period from the launch of the EMS to the post-Maastricht Treaty period by the

Deputy-Governor of the Bank of Italy, who played a crucial role in the politics and intellectual development of monetary union. Story, J. and Walter, I. (1997) *Political Economy of Financial Integration in Europe: The Battle of the Systems*, Manchester: Manchester University Press. Traces the repeated attempts of the EU to create a monetary union and a capital market, and analyses the transformation of national financial systems and the evolution of a European financial services regime.

JONATHAN STORY

Economic and Social Commission for Asia and the Pacific (ESCAP)

The Economic and Social Commission for Asia and the Pacific (ESCAP) is the largest of the five United Nations Regional Commissions, representing some 60 per cent of the world's population or 3.5 billion people. Established in the Chinese city of Shanghai in 1947, as the Economic Commission for Asia and the Far East (ECAFE), to assist with post-war economic reconstruction, the commission moved its headquarters to Bangkok in Thailand in January 1949. The name was changed in 1974 to reflect both the economic and social aspects of development, and the geographic location of its member-countries. ESCAP's mandate was broadened in 1977 by the UN General Assembly.

ESCAP members include Japan and Australia, the 'tiger economies' (such as the Republic of Korea, Singapore, Thailand, Indonesia, Malaysia and Hong Kong) and the new republics of Central Asia, which are undergoing rapid economic transition. Moreover, several of the world's LEAST-DEVELOPED COUNTRIES (LLDCs) and nineteen small Pacific island developing countries are members. ESCAP plays an unique role as the only intergovernmental forum for all the countries of the Asian and Pacific region, in the absence

of a regional grouping similar to the Organization of African Unity (OAU) or the Organization of American States (OAS).

The main objective of ESCAP is to bring some 830 million of the region's poor into the economic mainstream, enabling all its citizens to achieve a better standard of life, as envisaged in the Charter of the United Nations. Therefore poverty alleviation, improved education, infrastructural needs, a deteriorating environment and social rebuilding are at the centre of ESCAP's attention. The main activity of ESCAP is to give technical support to member governments for socioeconomic development through direct advisory services, training and sharing of regional experiences and information through meetings, seminars, publications and inter-country networks.

See also:

United Nations (UN); United Nations Economic Commission for Latin America (ECLA)

J.E.C. ENGELBERTS

Economic and Social Council (ECOSOC)

The Economic and Social Council (ECOSOC) was established by the Charter of the UNITED NATIONS (UN) as the principal organization (under the authority of the General Assembly) to promote (1) higher standards of living, full employment, and conditions for economic progress, social progress and development; (2) solutions to international economic, social, health and related problems, including international cultural and educational cooperation, and (3) universal respect for, and observance of, human rights and fundamental freedoms for all, without distinction as to race, sex, language or religion.

In order to achieve these objectives, ECOSOC coordinates the activities of such specialized UN agencies as the FOOD AND AGRICULTURE ORGANIZATION (FAO), the

United Nations International Development Organization (UNIDO) and the UNITED NATIONS CONFERENCE ON TRADE AND DEVELOPMENT (UNCTAD). It therefore serves as the central forum for the discussion of international economic and social issues of a global or interdisciplinary nature and for the formulation of policy recommendations on relevant issues. Moreover, the Council consults with NON-GOVERNMENTAL ORGANIZATIONS (NGOs) concerned with matters with which ECOSOC deals. Over 1,500 non-governmental organizations have a consultative status. NGOs with consultative status may send observers to public meetings of the Council and its subsidiary bodies, and may submit written statements relevant to the Council's work. They may also consult with the UN secretariat on matters of mutual concern.

ECOSOC has fifty-four members, elected for three-year terms by the General Assembly. Voting in the Council is by simple majority; each member has one vote. The Council generally holds one five- to six-week-long substantive session each year, alternating between New York and Geneva, and one organizational session in New York. The substantive session includes a high-level special meeting, attended by ministers and high officials, to discuss major economic and social issues. The year-round work of the Council is carried out by subsidiary bodies like commissions and committees.

J.E.C. ENGELBERTS

Economic Community of West African States (ECOWAS)

The Economic Community of West African States (ECOWAS) was founded in mid-1975 as an economic association of sixteen Anglophone and Francophone (plus one Lusophone) coastal and Sahelian countries from Nigeria in the east to Mauritania in the west. While its economic agenda remains ambitious – from the free movement of labour to free trade – its achievements are rather modest: neither regio-

nal trade liberalization nor a common external tariff has been established. National interests and structural adjustment conditionalities, on one hand, and continental and global connections, on the other, divert attentions from regional development. Informal trade exceeds formal exchange, Nigeria remains the dominant member, and subregional units – notably the COMMUNAUTÉ FINANCIÈRE AFRICAINE (CFA) – and currencies retain their salience.

Moreover, West Africa has been preoccupied over the last decade with ecological pressures – from droughts and DESERTIFICATION to floods and pests – and persistent conflicts in Liberia and then Sierra Leone. Chronic disunity in the region was exacerbated by 'interference' by neighbouring states, like Ghana and Côte d'Ivoire, on behalf of competing warlord factions in this regional struggle. Such destructive 'anarchy' included the use of child soldiers and later-day mercenary companies, as well as continued trade in diamonds and tropical timber. These interrelated challenges led to the formation of the ECOWAS Monitoring Group (ECOMOG), dominated by Nigeria, and related 'humanitarian interventions'. The exertion of fairly robust kinds of 'peace-making' eventually helped bring a degree of peace to both countries and the rest of the region by the late-1990s.

See also:

Central African Customs and Economic Union (CACEU); East African Community (EAC); West African Franc Zone

TIMOTHY M. SHAW

economic growth

The purpose of this entry is to discuss how different theories in the history of economic thought have dealt with the issue of effective demand and its relationship to the process of accumulation. The entry will address two related questions:

economic growth

- 1 Is economic growth endogenously generated via the normal operations of a market economy or does it need exogenous demand injections?
- 2 Is effective demand under normal circumstances sufficient to generate full employment?

The answers to these questions are profound, as they have important policy and political implications.

The dominant view is that of the neo-classical tradition, which traces its intellectual ancestry to Say and Ricardo. For Say, as for Ricardo, there are no barriers to growth in a *LAISSEZ-FAIRE* economy since supply generates its own demand. Ricardo, of course, recognized that the system can slow down because of a fall in the rate of profit caused by the declining productivity of the agricultural sector. But under normal conditions of accumulation, there could never be a 'general glut of commodities'.

This said, the parallels between these classical authors and the neo-classical tradition are not straightforward (Garegnani, 1983). For the classical authors, there was no assumption that self-sustained growth would also bring about general equilibrium with full employment. Moreover, for Ricardo and Say (as for MALTHUS) decisions to invest were identified with decisions to save. Unlike NEO-CLASSICAL ECONOMICS, there was no assumption that it was the INTEREST RATE which brought investment and savings in line with each other. On the other hand, the absence of a theory of money in Ricardo led him to conceive of money as a mere facilitator of exchange. Thus, as in neo-classical economics, exchange between commodities was seen as one involving the interchange of one good against another, since no one would want to hold money for its own sake (Giussani, 1983). Later, both KARL MARX and JOHN MAYNARD KEYNES were to criticize Ricardo for this, since people might desire to hold money for its own sake. This would break the circuit of capital and rupture the automatic equality of supply and demand (Foley, 1983).

The reformulation of the classical supply-side approach into the general equilibrium frame-

work also brought with it new models of growth. The early work by Solow (1956) produced the finding that a steady state level of output and growth was obtained by exogenous technological change. Ironically, this is a mechanism that one also finds in Kalecki (1971).

Efforts to endogenize growth within the neo-classical tradition brought forth a newer generation of RATIONAL EXPECTATIONS models (Romer, 1986) in which the production of innovations, and the corresponding EXTERNALITIES generated, would effectively endogenize the growth process. The representative agent methodology underpinning this research programme, however, precludes the problems of coordination between investors and savers, or borrowers and lenders, that Keynes and other economists have emphasized. In fact, disequilibria pose serious problems for these models, since they exhibit saddle-point instability (Flaschel, Franke and Semmler, 1997). Davidson and Kregel (1994) provide several critical evaluations of the logical consistency and historical originality of these models.

What is called the underconsumptionist tradition has provided a powerful and pervasive challenge to SUPPLY-SIDE ECONOMICS and unites a wide range of authors with often very different political beliefs. From Malthus and Sismondi through Rosa Luxemburg, Joan Robinson, Steindl and Kalecki it has been argued that in the absence of external driving factors the economy cannot grow (Bleaney, 1976; Shaikh, 1978). The rationale for this is as follows. Since wages are always less than the value of net output, workers' consumption is never sufficient to consume all of the latter. Capitalist consumption from profits is another source of demand, but savings from profits constitute a leakage from demand. Thus the system is said to face a demand gap which rises as the wage-share falls. On the other hand, if all profits are consumed, the demand gap would be filled but there would be no net investment. Thus, one way or the other, the system is doomed to stagnation. Authors such as Baran and Sweezy (1966) also stress the stagnationist effects of rising monopoly power, which

diminishes the share of wages and increases the pool of savings.

The question is: how does one explain periods of economic growth within the underconsumptionist context? Traditional underconsumptionists have argued that some exogenous consumption demand is needed to fill the demand gap. The modern version of this tradition holds that a rise in investment, the budget deficit or net exports could also fill the demand gap (Steindl, 1952; Baran and Sweezy, 1966; Kalecki, 1971). It follows, therefore, that the balance between the pull of these exogenous expansionary factors and the system's fundamental stagnationist tendencies would determine its actual growth trajectory. However, even with robust growth, most of these authors argue that the system cannot attain full employment.

For Keynes, the great merit of the traditional underconsumptionist school was that it had located the central importance of effective demand as a determinant of output and employment. Keynes, however, was interested in all the components of effective demand, especially planned investment. Criticizing what he called the 'classical school', Keynes argued that the imbalance between investment and saving would not be removed via changes in the interest rate, but rather via output and employment variations through the operation of the multiplier (see MULTIPLIER PRINCIPLE). Furthermore, for Keynes INVESTMENT rules the roost, because it is independent of saving in a monetary economy with a developed banking system. Moreover, the investment/saving equality was likely to be consistent with unemployment and excess capacity. In other words, wage and price flexibility would not automatically produce full employment.

Finally, as the debate between Keynes and Harrod (Kregel, 1980) made clear, the former had a static view of the economy, since his concern was with movements from one *level* of output to another. Growth could only take place via some exogenous rise in demand – for example, through an increase in 'animal spirits' which would raise investment. This is consistent with the underconsumptionist view of accumulation.

In his investigation of growth and effective demand in the second volume of *Capital*, MARX demonstrated that both aggregate demand and supply are determined by the consumption and investment decisions of the capitalist class. For simplicity, assume that all production takes one year and that the goods which are used over the course of the year are purchased at its beginning. At the start of the year, capitalists make their production plans in light of future demand expectations and existing profit flows. These flows originate from the historical process of capital accumulation which endogenously generates a stock of money capital, part of which circulates and part of which accumulates as hoards. Acceleration or deceleration of accumulation either reduces or increases these hoards.

Capitalists place orders for investment goods and hire workers who use their wages to purchase consumption goods. Thus workers' consumption is determined by investment. Given capitalist consumption out of profits, all three sources of demand constitute the total effective demand at the beginning of the new production period. This demand can be satisfied by the output of the previous year. Therefore, a capitalist economy does not require an external source of demand to grow, since it is capable of endogenously generating demand by aggregate capitalist spending. Further, whenever investment plans exceed available savings, the capitalist savings propensity adjusts to bring investment and savings into equality: internal finance is the principle driver of accumulation. Finally, for Marx, even at normal capacity, accumulation *requires* the persistence of structural unemployment.

Following the schemes of reproduction, can one conclude that capitalism can grow indefinitely? Some early Marxists, such as Tugan-Baranowsky and HILFERDING, in fact argued that state-planning in capitalism could eliminate crises. However, in Marx the analysis of the FALLING RATE OF PROFIT (FRP) (Shaikh, 1992) shows the endogenous links between competition, technological change and crises. A fall in the growth rate of the mass of profits lowers investment and therefore effective

demand, raises unemployment and, for a while, creates excess capacity. Thus, unlike neo-classical and underconsumptionist arguments, growth and crises are internally generated in the accumulation process in Marx.

The Marxian reproduction schemes only show the existence of a growth path, but do not deal either with its stability properties or with disequilibrium dynamics. The questions are (1) do disequilibria correct themselves in a market economy, and, (2) if they do, what are the implications for the stability of the growth path? These vital questions were taken up by Harrod and Domar in their growth models (see HARROD-DOMAR GROWTH MODEL).

Harrod rejected Keynes' static perspective in the *General Theory*, since his main disagreement with Keynes was with regard to a static versus a dynamic specification of the economy (Kregel, 1980). For Harrod, in a dynamic specification the point of departure has to be one at which growth takes place continuously. Further, he was interested in investigating cyclical fluctuations around such a growth path of output – that is, he was concerned with growth cycles (Harrod, 1951).

Beginning with the short-run equality between aggregate demand and supply, both Harrod (1939) and Domar (1946) were to focus on the slower adjustment processes involving discrepancies between actual and normal capacity. Recognizing both the aggregate-demand and productive-capacity effects of investment, their analysis produced the famous knife-edge problem, since they showed that normal market signals would cause any deviation between the actual and warranted growth rate to be aggravated rather than corrected. Thus Harrod and Domar concluded that the warranted path is unstable. Kalecki (1962) also came to this conclusion.

In a series of seminal papers, Shaikh (1989, 1991) demonstrated that the knife-edge problem arises because Harrod superimposed long-run dynamics on a short-run *level* of output established by the balance between aggregate demand and supply. The framework developed by Shaikh, and its extension into a social accounting matrix (SAM) model by

Moudud (1999), provide a solution to Harrod's problem and form the basis of a classical-Harrodian synthesis with distinctive policy implications. In contrast to the existing literature, the distinction between *ex ante* and *ex post* is fundamental to these models, since it allows for the possibility of macro-economic disequilibria. The models distinguish between circulating investment (raw materials, wages and so on) which, following Leontief, adds to output and fixed investment which adds to capacity. It is the combination of these two types of investment that produces a stable continuous path of output indicated by Harrod. Finally, along the warranted path normal capacity utilization is consistent with structural unemployment.

From a growth perspective, the most important question is whether a long-run disequilibrium adjustment process converges to the warranted path and oscillates around it. If it does, then capacity utilization will fluctuate around the normal level, so that the normal rate of profit will be established and growth will be internally generated from the reinvestment of profits, even if there is no technological change. However, if normal capacity growth is not attainable because of the knife-edge problem, the central role of profitability would have to be replaced by other regulating factors, such as population growth, waves of exogenously generated technological change, government spending, expectations and so on. The bulk of growth theory literature uses some combination of these factors to explain growth, because of the apparent inability of the system to sustain balanced growth. (See Sen (1970) and Hache (1979) for excellent discussions of this literature.)

During a period of global stagnation, the policy implications of these different theoretical traditions will be somewhat different. NEO-CLASSICAL ECONOMICS recommends austerity, especially cutting back budget deficits, as the principal way out of stagnation. For the modern underconsumptionist tradition, on the other hand, demand injections are the only solution. Finally, from the standpoint of the classical Harrodian synthesis, the crucial vari-

ables are the profit rate and the social savings rate. From this perspective, the emphasis on BUDGET DEFICITS in the other two traditions would appear to be excessive, especially since government spending can both crowd in and crowd out output (Moudud, 2000).

See also:

balanced growth; capitalism; capitalist crisis; crisis, global economic; crisis of world capitalism; crisis theory; depressions; disequilibrium; endogenous growth theory; Keynesian economics; long run; macro-economic policy; Marxian economics; overproduction; post-Keynesian economics; Say's Law

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economic growth, theories of

'Economic growth' has been defined as 'a sustained increase over a significant period of time in the quantity and/or quality of the goods and services produced in an economy' (Bougrine, 1999: 241). From the very birth of POLITICAL ECONOMY, the nature of the causes, sources or determinants of ECONOMIC GROWTH has remained the central question confronting successive generations of economists and others contributing to the discipline.

Economic growth has been variously conceptualized by economists in terms of stages, phases, cycles and long waves. Economists have also sought to measure long-term patterns of economic growth within and between nations. This growth accounting has identified the post-war era of the Bretton Woods international economic order as an era of exceptionally rapid growth (see BRETTON WOODS SYSTEM). By contrast, the period since the oil crisis of 1973 has been marked by much slower rates of growth for most economies. However, in both eras there has also been marked variation between national rates of growth with some economies, most notably the United Kingdom, in long-term relative decline. Until the onset of the 1990 collapse of the 'bubble economy' in Japan and the July 1997 Asian financial crisis (see ASIAN CRISIS), the remarkably high growth performance of the Asian 'tiger' economies had attracted particular attention from growth theorists.

Political economy has theorized economic growth in an even wider variety of state-market relationships, of which the most prominent recent examples have been state-led national systems of innovation and DEVELOPMENTAL STATES, and entrepreneur- and market-driven enterprise cultures. Despite this extensive theorizing, the causes, sources and determinants of economic growth have remained frustrat-

ingly elusive to the present day. This has been a particular frustration for politicians, because their prospects of election and re-election have increasingly depended on their capacity to deliver rates of economic growth sufficient to sustain rising living standards for the majority of the population.

Economic growth was first theorized in detail by the Classical School of political economy, whose motivation was the development of a scientific understanding of the forces affecting the development of industrial CAPITALISM in Britain and other industrializing economies. The Classical School identified the accumulation and productive investment of CAPITAL as the principal source of economic growth. The rate of surplus generated by an economy and its distribution between investment and rent would therefore be a key determinant of the rate of growth of an economy. For ADAM SMITH, a key factor would also be the development of a DIVISION OF LABOUR that would enhance the productive efficiency of the industrializing economy and its rapidly expanding markets.

The mainstream orthodoxy in subsequent economic theories of growth has been based on a neo-classical growth model rooted in 'a production function characterized by constant returns to scale and positive but diminishing marginal productivity of factors of production' (Crafts, 1996: 31). This theory has understood economic activity in terms of the union of discrete actors or factors in a linked set of markets, organized in distinct production functions. Economic growth has been understood as the combination of two different kinds of movement – namely,

the sum of movements along a production function (by intensifying labour processes, exploiting economies of scale, and replacing labour by capital: all in the context of a given stock of knowledge, a given technology); and of movements of whole production functions (as the stock of knowledge increases and technical progress ensues).

(Coates, 1999: 78)

Neo-classical growth theory therefore assumed that the production process entailed the transformation of raw materials using energy, labour and the means of production, such that a given quantity of the various inputs would generate a certain amount of the final product (Elster, 1983: 96).

Neo-classical growth theory has been periodically challenged by a variety of competing schools of political economy. Marxist political economy has criticized the growth orthodoxy for failing to take due account of the importance of class relationships and underlying structural contradictions within capitalist economies for their explanations of why growth rates have differed between rival economies (ibid.: 78). NEO-CLASSICAL ECONOMICS has also been criticized for its reduction of principal determinants of economic growth, notably technical progress, innovation and entrepreneurship, to unexplored, exogenous givens. This failure of neo-classical economics to adequately theorize the nature of technical change and innovation as sources of economic growth, provided the opportunity for JOSEPH SCHUMPETER to furnish an alternative theory of capitalist development that placed innovation and the entrepreneur at the heart of an understanding of the causes of economic growth.

Rather than portraying the entrepreneur as a rational profit maximizer, Schumpeter contended that the entrepreneur's motivation for innovation arose from

the dream and the will to found a private kingdom; the will to conquer, to succeed for the sake not of the fruits of success, but of success itself; and finally the joy of creating, of getting things done.

(Elster, 1983: 117)

Having identified the heroic individual entrepreneur as the source of innovations in goods, methods of production, new markets, raw materials and industrial organization in his *Theory of Capitalist Development* (1911), Schumpeter later contended in *Capitalism, Socialism and Democracy* (1942) that the

entrepreneurial function was increasingly obsolescent, as the process of economic growth became increasingly depersonalized and automated.

Schumpeter predicted that the perfectly bureaucratized giant industrial firm that was characteristic of 'trustified capitalism' would replace the entrepreneur and the small and medium-sized enterprise (SME) as the sources of innovation and economic growth. Indeed, the routinization of innovation driven by the founders of giant corporations, such as the Vanderbilts, Carnegies and Rockefellers, would eventually lead to the replacement of capitalism by SOCIALISM. However, the rise of the New Right in the final quarter of the twentieth century and the demise of COMMUNISM has witnessed precisely the opposite scenario, with a renewed political and academic interest in the political economy of the entrepreneur and the SME as prime movers of economic progress.

The principal innovation in post-neoclassical economic theories of growth has been the development of the new growth economics of ENDOGENOUS GROWTH THEORY which contends that 'long-run growth in income per head depends on investment decisions rather than, as in traditional growth theory, resulting from unexplained or exogenous improvements in technology'. For endogenous growth theory, investment

usually refers to a broader concept than the physical capital accumulation reported in the national accounts; human capital and/or research and development expenditures may well also be included.

(Crafts, 1996: 30)

Endogenous growth theory therefore implies that institutions and policies will have a greater influence on growth rates than is suggested by orthodox neo-classical economics. Indeed, as Nick Crafts has suggested, endogenous growth theory might have important implications not only for our understanding of economic growth but also for government policy, since the micro-economic foundations of investment decisions that give rise to economic growth, are

something which government investment is thought to be able to affect both through direct subsidies/tax reforms and indirect institutional reforms (ibid.: 31).

However, the potential dividend for the formulation of economic policy from endogenous growth theory has been questioned by Ben Fine. Despite the substitution of endogenous for exogenous variables in new growth theory, Fine has contended that new growth theory has actually maintained 'certain crucial aspects of methodology of its aged parent', because of its dependence on 'a division between an unexplained exogenous and an explained endogenous'. In short, endogenous growth theory 'is essentially a theory of the contribution that increases in factor inputs make to output in a perfectly functioning economy' which has failed to address, either theoretically or empirically, the potential contribution made to growth by other factors or indeed the impact of market imperfections (Fine, 2000: 249). Endogenous growth theory is therefore fundamentally flawed, because it has ignored the broader political, historical and social context of economic growth due to its deference to 'the requirements of axiomatic model-building associated with methodological individualism' (ibid.: 250).

Jan-Erik Lane and Sven Ersson have also identified the limitations of traditional economic models of growth that conceptualized growth 'as an endogenous variable determined by exogenous economic variables together with one or two instrument variables manipulable by means of economic policy' (Lane and Ersson, 1997: 146). This essentially reductionist and ahistorical approach to theorizing growth has treated politics as a 'black box' exogenous variable to be ignored or disregarded. To fill this lacuna in our understanding of the process of economic development, the political economy of economic growth has attempted to deliver theories of growth that integrate and accord due importance to the role of politics, history, culture and social conditions as determinants of economic growth both in the short and the long term. Lane and Ersson have suggested that there are two potential ap-

proaches to theorizing the relationship between politics and economic growth. First, politics may be identified as a factor that conditions economic growth rates in addition to or after the consideration of standard economic variables. Second, politics may be understood as a determinant of growth rates by virtue of its impact on economic variables (ibid.: 147). It is this latter approach which has tended to be more prevalent in the political economy of growth literature.

A seminal work and example of the theorizing of economic growth from a political economy (rather than a purely econometric) perspective is provided by *The Rise and Decline of Nations* (1982) by MANCUR OLSON, in which he contends that institutional sclerosis was a key political variable for understanding economic growth. His thesis was that the rise and decline of such industrialized nations as Japan, the United Kingdom and Germany could be largely explained in terms of the structure of distributional coalitions within each society – that is, the interest groups, trade unions and other combinations of individuals and companies that combine to influence government policy or raise the price of the goods and services they are producing. What Olson defined as the 'logic of collective action' would dictate that such coalitions would behave in a cartelistic or other manner detrimental to economic growth, because the benefits of such action would accrue to everyone in that coalition irrespective of their contribution to economic growth. Thus, for Olson, economic growth could be seen as a classic PUBLIC GOOD subject to a FREE RIDER PROBLEM from distributional coalitions whose capacity to capture short-term economic benefits for their members at the expense of longer-term economic development might result in institutional sclerosis becoming the principal barrier to economic growth.

Lane and Ersson have attempted to measure institutional sclerosis by applying Olson's model to the interpretation of economic growth data for the periods 1960–80 and 1985–94. By measuring one aspect of institutional sclerosis, namely the length of time of uninterrupted

existence of modern institutions, they concluded that institutional sclerosis was important when explaining the variation in growth rates among rich countries during the period 1960–80. However, Lane and Ersson could only partially corroborate Olson's model, because they also found that economic growth in poor countries had been driven by the nature of the economic regime and of INVESTMENT. Therefore, their ultimate conclusion about Olson's theory of economic growth was that 'variations in average economic growth rates have a complex background in behavioural and institutional factors, among which institutional sclerosis is only one' (Lane and Ersson, 1997: 170).

The value of Olson's ground-breaking analysis of the importance of institutions to an understanding of the determinants of economic growth has been reflected in the subsequent development of a huge literature devoted to an institutionalist perspective on growth. An important example of this perspective has been provided by Bernard Elbaum and William Lazonick's thesis of rival systems of competitive and corporate capitalism as the basis for competitive advantage during the late nineteenth and early twentieth centuries. Elbaum and Lazonick have contended that Britain, as the leading industrial nation, experienced slower rates of economic growth than its later industrializing competitors in Germany, Japan and the United States because it suffered from 'a matrix of rigid institutional structures' in 'its industrial relations, enterprise and market organization, education, finance, international trade, and state–enterprise relations' which prevented the transformation of its productive system. In contrast to these sclerotic institutions of competitive capitalism, more successful rival economies developed and consolidated institutions of corporate capitalism 'characterized by industrial oligopoly, hierarchical managerial bureaucracy, vertical integration of production and distribution, managerial control over job content and production standards, the integration of financial and industrial capital, and systematic research and development' (Elbaum and Lazonick, 1986: 2–4). Therefore, long-term varia-

tions in economic growth may be accounted for by the presence or absence of institutional structures conducive or detrimental to economic development.

The institutionalist theories of Olson, Elbaum and Lazonick have attempted primarily to explain variations in growth rates between nations. Michael Porter's research has advanced one major further step by explaining not only variations in national growth performance but also variations in innovation between industries and firms. Porter has sought to provide a convincing explanation of the national attributes that might foster competitive advantage in particular industries based on a diamond-shaped model. His thesis is that national advantage arises as the product of four interacting and mutually reinforcing variables. These variables are (1) factor conditions (that is, a nation's endowment of factors of production), (2) demand conditions (that is, the pattern of domestic demand for an industry's product or service), (3) related and supporting industries and (4) firm strategy, structure and rivalry. These four determinants of competitive advantage combine individually and collectively to create the national context in which the process of innovation and entrepreneurship is conducted (Porter, 1990: 71).

According to Porter's diamond, a nation's competitive industries will not be evenly spread across its economy or territory but will instead be connected by what he terms 'clusters' of related industries, which may cluster both vertically (as buyers and sellers) and horizontally (as common customers or because of shared technology or infrastructure). The process of factor creation through which a nation forms and upgrades its capital, physical and human infrastructure will be strongly influenced by its pattern of domestic rivalry, the presence (or absence) of related and supporting industries, and the quality and sophistication of demand conditions. If these factors are present in abundance and combine effectively, then a nation's industries will tend to grow. By the same token, if these conditions are absent, a nation will tend to decline.

The many other and wide-ranging attempts

to identify and theorize the political, cultural and social determinants of economic growth have resulted in some of the most heated debates within the discipline of political economy. One of the most important debates about the determinants of economic growth was generated by the WORLD BANK report *The East Asian Miracle* (1993), which sought to account for the extraordinary growth performance of eight Asian economies. The report asserted that around two-thirds of the growth in these high-performing economies could be attributed to high average annual rates of investment (especially in the private sector) in excess of 20 per cent of GROSS DOMESTIC PRODUCT (GDP) between 1960 and 1990, which in turn combined with high and rising endowment of human capital arising from universal primary and secondary education. The remaining third of economic growth could be accounted for by improved productivity, which had grown faster than in many rival developed and developing economies because of the unusual Asian success in both allocating capital to high-yielding investments and catching up technologically with more industrialized economies (World Bank, 1993: 8).

The World Bank report generated subsequent controversy not so much for this depiction of the pattern of Asian economic growth as for its adherence to the neo-classical orthodoxy that this growth performance had arisen 'by getting the basics right' and its conclusion that 'industrial policies were largely ineffective' (ibid.: 8, 312), seemingly contradicting an earlier admission that 'in most of the East Asian countries, in one form or another, the government intervened – systematically and through multiple channels' (ibid.: 5).

The most vehement critiques of the World Bank's analysis of the determinants of Asian economic growth have emanated from advocates of the critical and positive role played by the interventions of the Asian developmental state. For example, Alice Amsden has asserted that the macro-economic 'basics' so lauded by the World Bank cannot tell the entire Asian growth story and, indeed, must not be divorced from their micro-economic foundation of

supporting institutions (Asmden, 1994: 624). At the same time, the Bank's rejection of the importance of state-led industrial policy to Asian economic growth, simply because '[i]t is difficult to establish statistical links between growth and a specific intervention' (World Bank, 1993: 6), should itself be refuted because it is 'impossible to establish links between growth and non-intervention' (Amsden, 1994: 628).

The challenge mounted to neo-classical growth theory by developmental state theorists such as Alice Amsden, Robert Wade and Chalmers Johnson has itself been subject to a rejoinder from Alwyn Young. Young has claimed that it is 'largely incorrect' to assume that the economic growth rates of these Asian economies is attributable to extraordinarily high productivity growth, particularly in their manufacturing sectors. On the contrary, with the notable exception of Singapore, productivity growth in these economies has been neither particularly low nor extraordinarily high by post-war standards, with the consequence that neo-classical growth theory is actually able to account for most of the difference between the post-war growth performance of the Asian Tigers and that of their competitors.

Young's counter to developmental state theory has been supported by the work of Paul Krugman, who has concluded that

the remarkable record of East Asian growth has been matched by input growth so rapid that Asian economic growth, incredibly, ceases to be a mystery.

(Krugman, 1994: 76)

However, this neo-classical counterattack has itself been challenged by Dani Rodrik, who has refuted Krugman's claim that, since East Asian growth is known to have been propelled by investment, there is no need for further explanation. For Rodrik, the very fact that East Asian investment increased from 10 per cent to 30 per cent of GDP within only fifteen years, in economies where investment and savings decisions were made primarily by private entrepreneurs and households, should

itself be seen as sufficient cause for further research into the determinants of Asian economic growth (Rodrik, 1997: 422).

See also:

advantages of backwardness; competitiveness of nations; East Asian model; Fukuyama, Francis; Japanese model; List, Friedrich

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SIMON LEE

economic integration

'Integration', which in general means creating a single entity out of separate parts, has several meanings in economics. It may refer to (1) a process of strengthening relations between different countries or markets, which aims to remove particular obstacles that separate countries or markets; (2) the various kinds of relationships that may exist between different countries, the common institutions that may be established by them and the policy instruments

that they use, or (3) the end state of integration that is to be achieved.

A definition of economic integration that frequently appears in textbooks identifies the aim of integration as being the elimination of distortions between two or more economies. At its most basic form, this definition of integration entails the removal of restrictions on the trade of goods and services, and on the movement of labour and capital from one country to another. In a world where only border barriers exist, integration would lead to unification of national markets so that, in the absence of any transaction costs, prices would be equalized, factors of production would derive no advantage from being in one or another national market, and the national origin of goods, services and factors would be irrelevant to the decisions of economic agents.

Because obstacles to trade and factor movement are not only confined to border restrictions and because market, regulatory, legal, social and political conditions vary from country to country, elimination of distortions would require, at minimum, not only the abolition of border barriers but also the provision of NATIONAL TREATMENT to foreign products and factors. National treatment means, in this context, the absence of discrimination on the basis of nationality.

As long as economic conditions differ between partner countries, non-discrimination is a necessary but not sufficient condition for integration. For example, a non-discriminatory regulation may still obstruct entry of partner-country products or factors because it may be stricter than the equivalent regulation in their home market. Also, regulations of a similar level of strictness may still impede the trade of products and movement of factors if they are applied without regard to whether the relevant authorities in partner countries have already implemented similar regulations. Hence, there may be unnecessary regulatory duplication, even if the regulations are non-discriminatory. Regulatory duplication is costly because it requires unnecessary compliance and the imposition of unnecessary costs discourages the trade of products and movement of factors.

In order to deal with the problems of varying regulatory levels and regulatory duplication, partner-countries need to coordinate their policy-making processes. This kind of policy coordination may begin with simple consultation and extend to joint decision-making. Joint decision-making itself may take different forms. Common policies may be decided in common by the representatives of partner-countries or they may be delegated to an independent agency established as a supra-national institution to formulate and implement such policies. For example, in the EUROPEAN UNION (EU), the Commission is responsible for enforcing certain policies (controlling, for example, state aid) and for representing the EU in international fora.

Despite the very large literature on economic integration, four fundamental issues remain unresolved: (1) there is no definition of the state of 'perfect' integration; (2) there is no definition of the process and instruments for achieving that state of perfect integration; (3) to the extent that it may be in the interest of participating countries to retain some degree of policy autonomy and to tolerate a certain amount of 'friction' between their economies, there is no measure of the optimum balance of integration (that is, how much integration is good for a country), and (4) in the same way that it is virtually impossible to identify the optimum balance of integration, it is also very difficult to be certain as to the optimum extent of delegation of decision-making authority to the common institutions created by the integrating countries.

The definition of economic integration given at the beginning essentially conceives integration as a process. It follows that the end of this process is the stage at which all distortions between the partner-countries are eliminated. But, given the imperfections that exist in all economies, the end stage where no distortions exist is both indefinable and unachievable.

Nonetheless, integration has also been treated in the literature as signifying the various stages of increasingly closer economic ties. The most commonly identified of these stages are FREE TRADE AREAS (FTAs), CUSTOMS UNIONS

(CUS), COMMON MARKETS and full economic unions. There is, however, no automatic or necessary movement from a lower stage to a higher stage. Most countries participating in regional integration schemes stop at free trade areas. Fewer move on to customs unions, while fewer still enter into economic unions. Theory offers no prescriptions about the stage at which countries should stop or about which policies should be brought under joint decision-making in common markets and economic unions.

A popular explanation of economic integration in western Europe in the form of the EU is that successful integration spills over from one policy area into another, creating a 'snowball' effect that leads to further supranational cooperation and joint action. However, apart from the fact that this explanation runs the risk of being a generalization from a sample of one and that it ignores the many instances of failed integration where 'snowballing' did not materialize and initial success fizzled out, it does not account for the reasons why partner-countries willingly accept further constraints on their policy discretion. Their agreement to surrender national policy discretion to supranational decision-making and scrutiny has been attributed partly to the fact that, from the beginning, the EU built strong supranational institutions which have in some instances forced and in others goaded member-countries into deeper integration.

The debate in the EU – first with the signing of the MAASTRICHT TREATY in 1992 and then with the introduction of a single currency in 1999, accompanied by the subsequent revision of the Maastricht Treaty in 1997 and 2000 (the Treaties of Amsterdam and Nice respectively) – reveals that the process of economic integration is neither inevitable nor predetermined. Above all, it requires that partner-countries share the same political views about the eventual end state of that process.

See also:

Single European Act (SEA)

Further reading

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PHEDON NICOLAIDES

economic interdependence

The issue of economic interdependence and its effects is taking on renewed importance as levels of commerce between nations grow to new heights. In 1960, trade as a percentage of GROSS NATIONAL PRODUCT (GNP) for the United States, Britain, France and Germany was 7, 32, 23 and 30 per cent respectively; by 1996, these figures were 24, 59, 45 and 47 per cent respectively. Whether economic interdependence will be a force for peace or for conflict is hotly debated within international relations (IR) scholarship. Liberals argue that such interdependence lowers the likelihood of war by increasing the value of trading over the alternative of aggression: interdependent states would rather trade than invade. Realists dismiss this argument, countering that high interdependence only increases the probability of war, as dependent states struggle to ensure continued access to vital goods (see REALISM).

The disagreement between liberals and realists is rooted in their understanding of the notion of economic interdependence. Both camps agree that interdependence is mutual DEPENDENCE between two or more states, with dependence in the most general sense meaning simply that each state is significantly affected by external economic forces (Keohane and Nye, 1977: 8). Liberals emphasize two elements of interdependence: sensitivity and vulnerability (see SENSITIVITY, ECONOMIC; VULNERABILITY, ECONOMIC). Sensitivity interdependence involves costs to the state that result from the ongoing activities of trade and commerce, such as losses in state autonomy and the effect of

price changes in one country on another. Vulnerability interdependence, for liberals, involves the costs a nation might suffer, even after having adjusted policy to deal with an external shock. More significantly, however, as David Baldwin (1980) has noted, it refers to the opportunity costs that a nation would experience if trade and commerce with the other state were to be cut off completely.

For realists, only this latter notion of vulnerability interdependence is important. Yet realists have a more expansive conception of the opportunity costs resulting from severed trade. In the liberal view, these costs tend to be thought of as simply the loss of the original benefits or 'gains from trade' received by moving away from AUTARKY (the no-trade position). For realists, however, the decision to trade is a decision to specialize in certain goods, while foregoing the production of other goods. After the economy is so restructured, realists emphasize, there will be huge 'costs of adjustment' if trade is subsequently severed. This is especially problematic should the state come to depend on others for so-called 'vital goods' like oil and raw materials. A state that is cut off from trade after basing its economic structure around imported oil, for example, may actually be put in a far worse situation than if it had never moved away from autarky in the first place.

By combining the liberal emphasis on the gains from trade and the realist focus on the costs of adjustment, we can arrive at a clearer understanding of any particular state's total level of 'dependence' within an interdependent relationship. On a bilateral basis, that level is represented by the sum of the benefits that the state would receive from free and open trade with another state (versus autarky), and the costs to the state of being cut off from that trade after having specialized (versus autarky). If State A started with an economy of 100 units of GNP before any trade with State B (the autarkic position) and open trade with B would mean economic expansion to a level of 110 units of GNP on an ongoing basis, then the 'benefits of trade' could be considered as 10 units. If the specialization that trade entails,

however, would mean the economy would fall to 85 units should B sever trade ties, then the 'costs of severed trade' would be 15 units versus autarky. State A's total dependence level would thus be the benefits of trade plus the costs of severed trade after specialization, or 25 units.

This discussion helps to clarify why liberals and realists take such opposite views on the question of whether economic interdependence leads to peace or conflict. For liberals, trade provides valuable benefits to the economy. Interdependent states should therefore seek to avoid war, since peaceful trading gives them all the benefits of close ties without any of the costs and risks associated with military conflict. As Richard Rosecrance puts it, there is no incentive to wage war in highly interdependent systems, since 'trading states recognize that they can do better through [trade] ... than by trying to conquer and assimilate large tracts of land' (Rosecrance, 1986: 24-5). Realists, however, emphasize that in an anarchic system, where there is no central authority to guarantee long-term trade, states must worry about the devastating effects of possible cut-offs in imported goods. Dependent states will thus seek to expand against those nations that supply vital goods, in order to reduce their future vulnerability (Waltz, 1979: 106). This argument draws from the traditional mercantilist logic (see MERCANTILISM) that states needing supplies and markets will try to minimize their dependence through colonial IMPERIALISM.

It is worth noting that despite the differences between liberal and realist arguments, they possess one important similarity: the causal logic of both perspectives is founded on an individual state's decision-making process. That is, while both camps freely use the term 'interdependence', both derive predictions on the likelihood for conflict from how particular decision-making units – states – deal with their own specific dependence. This allows both theories to handle situations of asymmetrical interdependence, in which one state in a relationship is more dependent than the other (see INTERDEPENDENCE, ASYMMETRICAL). Their

predictions are internally consistent, but opposed: liberals argue that the more dependent state is less likely to initiate conflict, since it has more to lose from breaking economic ties; realists maintain that this state is more likely to initiate conflict, to escape its vulnerability.

As for empirical evidence, both liberal and realist theories have difficulties explaining the run-up to the two World Wars. The period up to World War I exposes a glaring anomaly for liberal theory: European powers had reached unprecedented levels of trade, yet war still occurred. Realists have the correlation right – war was preceded by high interdependence – but trade levels had been high for the previous thirty years; hence, even if interdependence was a necessary condition for the war, it was not sufficient.

The period from 1920 to 1940 seems to support liberalism over realism. In the 1920s, interdependence was high and the world was peaceful; in the 1930s, as protectionism caused interdependence to fall, tension rose to the point of world war. Yet the two most aggressive states in the system during the 1930s, Germany and Japan, were also the most highly dependent, despite their efforts towards autarky, relying on other states (including other great powers) for critical raw materials. Realism thus seems correct in arguing that high dependence may lead to conflict, as states use war to ensure access to vital goods. Realism's problem with the inter-war era, however, is that Germany and Japan had been even more dependent in the 1920s, yet they sought war only in the late 1930s when their dependence, although still significant, had fallen.

One way to help resolve the debate between liberals and realists is to introduce additional causal factors that specify the conditions under which economic interdependence will probably lead either to peace or to conflict. A dependent state's expectations for future trade, for example, can be critical in determining whether the liberal or realist logic will apply. If the state has positive expectations that others will maintain open trade in the future, then the benefits of trade, as per the liberal argument, will reduce the incentive for war: the dependent state will

compare the high value of peaceful trade to the costs and risks of conflict, and choose peace. If, however, highly interdependent states expect that trade will be severely restricted – that is, if their expectations for future trade are pessimistic – realists are likely to be right: the most highly dependent states will be the ones most likely to initiate war and conflict, for fear of losing the economic wealth that supports their long-term security. Thus, high interdependence can be either peace-inducing or war-inducing, depending on the expectations of future trade (Copeland, 1996).

Such a dynamic perspective offers one method to bridge the gaps within and between the two current approaches. Separating levels of interdependence from expectations of future trade indicates that states may be pushed into war even if current trade levels are high, if leaders have good reason to suspect that others will cut them off in the future. In such a situation, the expected value of trade will probably be negative and hence the value of continued peace is also negative, making military conflict an attractive alternative. This point helps resolve the liberal problem with World War I: despite high trade levels in 1913–14, declining expectations for future trade pushed German leaders to attack the system to ensure long-term access to markets and raw materials.

Even if current trade is low or non-existent, positive expectations for future trade will produce a positive expected value for trade and therefore an incentive for continued peace. This helps explain the two main periods of DÉTENTE between the COLD WAR superpowers, from 1971 to 1973 and in the late 1980s: positive signs from US leaders that trade would soon be significantly increased coaxed the Soviets into a more cooperative relationship, reducing the probability of war. Yet in situations of minimal trade, where there is no prospect that high trade levels will be restored in the future, highly dependent states are pushed into conflict. This was the German and Japanese dilemma before World War II.

Research in the late 1990s has revolved around a number of distinct but overlapping

economic leadership

topics, including the diplomatic and domestic origins of trade expectations; the relative influence of different forms of economic interdependence (trade/GNP ratio, dependence on strategic goods, presence of alternative suppliers, monetary interdependence and so on); the importance of asymmetries in mutual dependence, and the impact of geographic proximity and great-power/small-power status on interdependence's effect on the likelihood of conflict. Also of interest is whether economic interdependence interacts with the existence of shared democratic regime-types to help keep the peace, as Oneal and Russett (1997) suggest.

See also:

colonialism; globalization; interconnectedness; interdependence; liberalism; symmetrical interdependence

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DALE C. COPELAND

economic leadership

According to the classical liberal economic perspective, the market economy has a powerful tendency to equilibrium and stability, and the foundation of this stability is a set of economic laws that are distinct from politics. Unless there is a clear sign of MARKET FAILURE or a PUBLIC GOOD issue is involved, the public sector ('politics') should not intervene in the self-correcting free market ('economics'). According to this view, increase in human WELFARE or economic EFFICIENCY can only be hindered by the self-defeating attempts of the public sector to improve the market economy. Governments can therefore best exhibit 'economic leadership' by not interfering in the self-corrective ethos of the market economy.

An institutional offshoot of the liberal economy school would argue that it is not possible to divide politics and economics so neatly into different spheres. According to this neo-institutional liberal view, true economic leadership is determined less by the propensity to intervene in the market and more by the willingness to establish and maintain liberal economic norms.

HEGEMONIC STABILITY THEORY argues that an open and liberal world economy requires the existence of what ROBERT KEOHANE calls

'hegemonic' or dominant power, or what CHARLES KINDLEBERGER referred to as 'leadership'. Although Kindleberger is often identified with the theory of hegemonic stability, he frequently used the term 'leadership' to describe the establishment and maintenance of these liberal economic norms. According to this theory, an economic hegemon or leader is necessary to establish and maintain the norms of a liberal economic order. It is possible to have an international economy without an economic leader, but this theory precludes the possibility of a liberal international economy. There have to be, however, other constitutive components in order for an economic leader to construct this liberal economic order:

- 1 An economic leader has to be committed to what a classical political economist might refer to as the values of a liberal economic order – that is, a free market, open exchange and other values. Without such a commitment, there is little to distinguish an economic leader from an economic despot.
- 2 There have to be other states that are willing to follow the direction set by the economic leader. Unlike a despot, a hegemon can only encourage, never force other states to follow its economic leadership.
- 3 An economic leader has to have what ROBERT GILPIN calls 'ideological hegemony'. If other states begin to regard the actions of an economic leader as self-serving, the entire hegemonic system might break apart. According to Gilpin, if the costs of leadership begin to exceed the perceived benefits, countries become less and less willing to subordinate their interests to the continuation of the hegemonic system.

Since the continuation of an open global economy can be seen as a type of a public or COLLECTIVE GOOD, the theory of hegemonic stability argues that an economic leader is necessary to prevent FREE RIDER PROBLEMS, enforce the rules of an open international economy and, most importantly, sacrifice its own self-interest in order to hold up the values of an open market economy.

Embedded in this philosophy of political economy is the strong liberal faith that trade and economic INTERDEPENDENCE lead to an increasingly peaceful co-existence among nations. However imperfect, the post-war BRETON WOODS SYSTEM was a good example of this liberal faith in trade and economic interdependence. For more than fifty years, a hegemon in the form of the United States has provided the necessary economic leadership for the establishment and the maintenance of a liberal global trade and economic regime.

An important question that has not been resolved yet is the role of an economic hegemon in an age of intensifying economic globalism and a growing private financial marketplace. Can a single nation, even one that is as powerful as the United States, provide sufficient economic leadership to maintain the liberal global trade and economic regime by itself?

See also:

economic interdependence; hegemonic decline; hegemony, US

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economic nationalism

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JACOB PARK

economic nationalism

Economic nationalism is an ideology which has been widely used as the motive force for national development strategies, especially in late industrializing economies and post-colonial regimes. It has been frequently associated with MERCANTILISM and the pursuit of AUTARKY (that is, economic self-sufficiency). Michael Heilperin has defined economic nationalism as

a body of economic policies aimed at the loosening of the organic links between economic processes taking place within the boundaries of a country and those taking place beyond these boundaries.

(Heilperin, 1960: 27)

The key to this definition is the notion of a degree of insulation, although not necessarily isolation, of a nation's economy from the rest of the international economy. Economic nationalism has therefore been portrayed as 'the policy of self-sufficiency' (Rappard, 1937: 84).

In the nineteenth century, the principal proponents of developmental strategies based on economic nationalism were FRIEDRICH LIST and ALEXANDER HAMILTON, who in particular advocated INFANT-INDUSTRY PROTECTION (Earle, 1991). In the twentieth century, economic nationalism reached new heights in the 1930s with the conduct of international trade

through BEGGAR-THY-NEIGHBOUR POLICIES of protectionism.

William Rappard (1937: 85-7) has argued that there are four tenets of economic nationalism:

- 1 Economic nationalism aims to restrict national consumption to those goods and services which are the product of its own land and population. This objective has been pursued by the use of appeals to patriotism, as well as policy instruments such as the imposition of tariffs and quotas on imports, exchange controls and the protection of 'infant industries' from foreign competition.
- 2 Economic nationalism aims to promote the domestic production of those essential commodities for which the national needs are imperative. This objective may mean the NATIONALIZATION of key industries, such as water, gas, coal and electricity.
- 3 Economic nationalism has been used as a justification for territorial expansion, through the annexation of neighbouring or colonial territories, to provide more space for the national population or to secure access to land, raw materials and markets vital for national economic development.
- 4 Because no state can insulate itself entirely from the modern international economy, economic nationalism has sought a favourable BALANCE OF PAYMENTS to ensure access to the ready supply of foreign currency required to purchase imports of those raw materials or manufactures required for economic development.

During the post-war period, many THIRD WORLD post-colonial governments adopted economic nationalism as the basis for their development programmes. During the 1980s, the popularity of economic nationalism as a developmental ideology has waned with the ascendancy of New Right political economy and the prevalence of NEO-CLASSICAL ECONOMICS at the INTERNATIONAL MONETARY FUND (IMF) and WORLD BANK. Economic nationalism has been widely supplanted by the privatization of nationalized industries and the

DEREGULATION and LIBERALIZATION of trade and markets, as politicians have eagerly embraced a strategy that attributes all responsibility for economic problems to market failure rather than their own governmental mistakes.

See also:

industrial policy

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SIMON LEE

economic policy, national

'National economic policy' has been defined as government decisions which affect the allocation and distribution of resources. The key instruments are legislation, government expenditure, and its financing by taxation, borrowing or issuing money.

(Levacic, 1992: 656)

National economic policy has tended to be subdivided into MACRO-ECONOMIC POLICY and MICRO-ECONOMIC POLICY. The principal instruments of macro-economic policy have been monetary policy – that is, government policies in relation to the control of the money supply, the rate of inflation, and the level of interest and exchange rates (see MONETARY POLICIES) – and fiscal policy – that is, government policy in relation to public spending and the level of direct and indirect taxation on individuals and corporations (see FISCAL POLICY). The principal instrument of micro-economic policy has been INDUSTRIAL POLICY – that is, government policy intended to develop or restructure specific industries and sectors with a view to maintaining their growth, output and international competitiveness.

Since the late 1970s, the principle and practice of state intervention and public expenditure has been challenged by both the ideology of the New Right and the increasing internationalization of the world economy. Economic policies such as PRIVATIZATION and DEREGULATION have sought to reduce the role of the state in economic development. In addition, the purported GLOBALIZATION of trade and financial markets has been held to have fatally undermined national economic SOVEREIGNTY. However, Linda Weiss and others have suggested that globalization tendencies have been exaggerated and economic policy is becoming increasingly important as a means for nation-states to adapt their economies to the demands of internationalization (Weiss, 1998: 212).

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the idea that globalization has undermined the importance of national economic policy.

SIMON LEE

economic power

Power is commonly viewed as the ability to get others to do what they would otherwise not do. Economic power is a particular type of power, but it is not always clear what this means. The term 'economic power' is used in at least three different ways. One refers to the kind of behaviour being changed. Thus, getting others to change their economic behaviour is sometimes described as economic power: for example, a country that can cause other countries to lower trade barriers, change interest rates, or accept foreign investment is sometimes described as exercising economic power. A second conception of economic power is the use of economic means to affect economic behaviour. Thus, threatening a trade embargo or reducing foreign aid in order to get another country to change its tariff policy would be considered economic power. A third conception of economic power defines it in terms of the means used, regardless of the type of behaviour being affected. According to this conception of economic power, economic policy instruments could be used to change the behaviour of another country with respect to human rights, drug trafficking, arms sales, nuclear weapons development and so on.

Each of these conceptions of economic power involves analytical difficulties. Defining economic power in terms of the kind of behaviour being influenced is problematic because the same effect can often be achieved by a variety of means. For example, military force can be used to get another country to change its economic behaviour, and in this case the distinction between military and economic power is blurred. The military theorist Carl von Clausewitz (1976 [1832]) argued that what is distinctive about military force is the means used, not the ends sought.

All three conceptions of economic power are vulnerable to the criticism that they obscure the relational nature of power. If power is conceived in relational terms, it cannot be described solely in terms of the properties of a single actor. To say that Actor A has power with respect to Actor B is to say something about both. The money that allows one to bribe a corrupt public official may be useless in trying to bribe an honest one. Likewise, a trade embargo may be quite effective in changing the behaviour of one country and virtually useless with respect to another. A power relationship is a function of both the resources available to Actor A (the wielder of power) and the value system of Actor B (the target of the influence attempt). Thus, Actor A may have the ability to affect the amount of Actor B's wealth but, if Actor B does not place much value on wealth, Actor A's ability to influence Actor B will be curtailed.

The belief that it is possible to separate politics and economics sometimes generates calls to depoliticize international trade by leaving it in the hands of private firms. ALBERT O. HIRSCHMAN (1945), however, demonstrated that this is impossible in a world of sovereign states. He argued that the ability of any sovereign state to cut off trade with other states means that international trading relations always have a political dimension. He called this the 'influence effect'.

Economic power is not confined to negative sanctions, namely, actual or threatened punishments. Economic power can also be exercised through positive sanctions, namely, actual or promised rewards. Thus, both giving and withholding aid are attempts to wield economic power.

In sum, the term economic power requires specification as to who is trying to get whom to do what by what means. Just as military power is distinguished by its means, economic power is most usefully distinguished from other forms of power by the means used. All international economic relationships have an actual or potential power dimension. Economic power may take the form of negative or positive sanctions.

See also:

commodity power; diplomacy, economic; power; sanctions, economic; structural power

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DAVID A. BALDWIN

economic realism

Economic realism is one of the three major approaches used to assess and understand developments in the international economy. Specifically, economic realism provides a framework alternative to the standard neo-classical and Marxist models (see MARXIAN ECONOMICS; NEO-CLASSICAL ECONOMICS) for identifying

the underlying forces and dynamics of the world economic system. Much of the recent economic realism literature has its origins in the earlier works of David Calleo and Benjamin Rowland (1973), Robert Gilpin (1975, 1987) and R.J. Barry Jones (1986). Jones notes that the economic realist approach derives its name from the fact that it reflects and accommodates the complex set of realities exhibited by the empirical world. While the neo-classical approach is much more analytical and sophisticated, to many people that approach's over-reliance on market solutions provides little insight into the real factors at play in the international system. To realists, such an approach is of extremely limited value for providing concrete policy recommendations.

Antecedents

As the liberal approach evolved out of micro-economic theory and the literature on free-market capitalism, economic realism evolved out of the STRUCTURAL REALISM school of international relations (IR) and the mercantilist school of international trade (see MERCANTILISM). Structural realism makes the following set of assumptions: states (see STATE, THE) are the key actors in IR; states interact in an anarchic environment devoid of rules and enforcers, and (as a consequence of anarchy) much of their behaviour is shaped by the possibility of war and the necessity of preparing to deter or defeat military challengers. The threat of war leads each state to maintain its own defence capabilities and to form loose alliances whenever possible with states that share common defence interests. Although structural realists disagree about foreign policy prescriptions that can be derived from the theory, the following are broadly accepted:

- 1 States tend to balance against military threats, not bandwagon with them. Secondary states (if they are free to choose) flock to the weaker side, as it is the stronger side that threatens them.
- 2 States prefer to maintain independent

military capabilities. Although states will form loose military alliances in order to balance against primary threats, they will guard themselves against the possible defection of allies by maintaining a full array of military forces and will resist the specialization of their military forces in the interest of greater alliance rationality.

- 3 Powerful states are more prone to follow Predictions 1 and 2 than are weak states.

While the IR school of realism has been largely silent on economic issues and on how economic and military security concerns relate to one another, the following propositions capture the basic thrust of their arguments: States will be highly sensitive to the relative economic gains of other states they consider military threats. Realists agree that less trade will occur than is rational from a classical economic standpoint. Given that trade may benefit one partner relatively more than the other and that trade involves the specialization of labour between states, states will restrict trade in order to avoid shifts in the balance of power or dependency on trade partners for goods that may be critical in the event of war.

The trade-inhibiting effects of differential benefits from trade will be muted within alliances and between partners that are not potential military competitors. The greater the perceived military threat to a state, the more that state will pay in order to maintain its alliance relationships. How the costs of a military alliance will be divided among component members will be affected by the relative military dependence of the states involved. When a state faces both a high degree of military threat and the possibility of defection by allies, it will pay relatively more to entangle its partners and reduce the likelihood of abandonment.

Economic (mercantilist) realism draws on structural realism to derive a series of propositions about the conduct of state affairs in the economic realm. Here the key idea is that TECHNOLOGY and national wealth should be given prominence in providing security. This line of thought has its antecedents in the

nineteenth-century neo-mercantilist propositions of ALEXANDER HAMILTON and FRIEDRICH LIST (see NEO-MERCANTILISM) and the mid-twentieth-century insights of JOSEPH SCHUMPETER, E.H. CARR and ELI HECKSCHER. Hamilton and List stress that states must nurture their manufacturing capacity to remain strong; Hecksher and Carr maintain that states can use economic power to unify and dominate the system within their sphere, and Schumpeter argues that innovation is the most dynamic source of structural change and power in capitalist economies.

Initially, the common purpose of mercantilist measures was to promote the strength and potential power of the state and its ruler(s) against other communities with which conflicts of interest (and of arms) might develop. Classical mercantilism was seen to be primarily bullionist (see BULLIONISM), with policy being directed towards the accumulation of bullion, specie and all other readily transportable forms of wealth that might be used for recruiting and sustaining armed forces. Later classical mercantilism broadened its vision to include the promotion and protection of society's general economic strength and capacity, and the establishment of a strategically advantageous balance of trade with other states.

Although traditional mercantilists and classical realists have been concerned largely with the connection between national wealth and national military power, the policies designed to enhance the technological and economic fortunes of states may be pursued to increase a state's political leverage and independence, even in the absence of military-security considerations. In developing predictions consistent with a mercantile version of realist theory, the literature generally assumes that broad segments of the elite in some states might embrace three ideas: (1) the possibility that the efficacy of appeals to arms has, for a variety of reasons, declined dramatically during the course of the twentieth century; (2) national economic power can be used to constrain the sovereignty or independence of states, and (3) national economic power can be enhanced through industrial and trade policies designed

to create COMPARATIVE ADVANTAGE in critical high-technology sectors.

In its classical formulation, REALISM was a comprehensive theory about state behaviour. Only during the COLD WAR did it become closely associated with the more narrow logic of military competition. At its core, classical realism is a theory of the state and international competition. It is not primarily a theory about how states acquire security or about defence issues. In fact, the best treatments of realism's intellectual roots are not found in the security side, but rather in its more overlooked economic philosophy of mercantilism.

Despite differences in goals, structural and economic (mercantile) realism have several elements in common. Each is 'realist' because each posits states as the most important actors in world politics; each assumes that state behaviour is determined by rational national leaders seeking to maximize state power, and each suggests a competition among states for relative power and security. Despite sharing core elements, economic (mercantile) and structural realism produce divergent predictions under many global and regional political conditions. These differences involve more than differential rates of military investment or trade policies. They comprise a broad range of preferences, including the question of how elites define threats and select allies, as well as how they conduct themselves with stakes that they find threatening and those they find non-threatening.

Several propositions associated with economic (mercantile) realism illustrate how this approach differs from those of structural realism: (1) security threats are economic, as well as military; (2) powerful techno-economic states will balance against other techno-economic states; (3) when trade-offs must be made, techno-economic interests may be pursued at the expense of political-military interests, and (4) the nationality of firms matters as much as or more than the location of production.

Under structural realism, the primary threat to state security is from direct attack. The equivalent to military conquest in mercantile

realism is DEINDUSTRIALIZATION or dependency. States that intervene in their national economies to nurture domestic producers are acting to protect domestic markets from the economic equivalent of direct attack; we would thus expect states to justify these interventions as matters of national security that will therefore entail the sorts of national mobilization and sacrifice associated with military mobilization elsewhere. It follows that such states should be particularly sensitive to technological dependency.

Given that technological capabilities are essential for prosperity in industrial economies, timely access to technology is a matter of national security. The dangers of excessive dependence are measured as more than 'vulnerability' to access denied; there are opportunity costs of foregone chances to learn and to innovate. Economic (mercantile) realists will also worry about exploitation by technological leaders who would use their market power to influence purchases, to rent-seek (raise prices – see RENT SEEKING), to extort by allocating or denying supplies for strategic reasons, and to be predatory by driving another nation's producers from the market entirely. Economic realists refer to the consequence of such dependency: the reduction of national firms to assemblers, handlers and retailers unable to reap the full profits of manufacturing and innovation.

States may balance both economically and politically against rival industrial powers even when those nations pose little military threat; conversely, close economic and political relations may be pursued with states possessing complementary economies, even when such behaviour entails some degree of future military risk. States may adopt a wide array of measures, including strengthening ties with economically less-threatening partners, in order to mitigate this danger. As in structural realism, balancing behaviour is most likely to characterize the behaviour of major industrial states. Technologically weak states may have little choice but to integrate their economies ('bandwagon') with the dominant partner. The economic bloc that would ensue is the

mercantile realist analogue to the military alliance in structural realism. Under economic realism, states will also balance against others based on judgement of their strength, position and behaviour, but these judgements will conform to a techno-economic logic.

Strength in the mercantile world is not always determined by size, population or military capability, but also sometimes by wealth and technology. While these have hardly been unrelated historically, they are not always co-variant and should be distinguished analytically. Economic realists will balance against wealthy states that are endowed with technology-intensive industries.

Position in the mercantile world is defined by its industrial structure, rather than by its physical geography. States that compete in the same sectors will tend to view one another as threatening and mercantile realists will minimize intra-industry trade. While military strengths rapidly attenuate across space, technological power and the ability to profit from it are not. Hence, in the context of global markets, states far away may pose as big a threat as those that share common borders.

States will balance against others that behave as economic predators. Moreover, because the behaviour of other states may be misinterpreted under mercantile realism, just as it may in the world of structural realism, we can imagine the problem of techno-economic 'security dilemmas' in which defensive efforts made by one state (for example, to protect infant industries) may be viewed by trading partners as aggressive actions to which they might respond with tariffs and other sanctions.

Nations may be forced to choose between maximizing techno-economic values or maximizing political-military values. Structural realists argue that when forced to make this choice, states will seek to achieve political-military goals first. Military security is like oxygen, they assert: it is taken for granted until there is too little of it, at which point, states will do anything to get more. Economic realists respond that economic security is just as important, adding that once economic security is gone, it is difficult to recover (see SECURITY,

ECONOMIC). A state with a powerful technological and industrial base is capable of transforming itself from a military pygmy into a military giant within a short span of time, whereas states with large militaries that allow their industrial and technological base to wither find themselves in a more difficult predicament. They may thus be unable to protect themselves from either economic coercion or military threats.

Even in a global economy, economic realists assume that firms have (and will retain) a national centre of gravity. States therefore seek not only to nurture firms within their borders, but also to support national firms abroad. These firms are more comfortable trading with co-nationals sited abroad than they are with foreign-owned entities at home. It follows that outward FOREIGN DIRECT INVESTMENT (FDI) can be used to entangle allies and to create dependence that serves national ends, while inward direct investment can be carefully monitored and circumscribed to prevent the same result. Under structural realism, the physical location of production may be more important, because production assets may be nationalized in the event of war.

Modern neo-mercantilism

The main thrust of modern-day economic realism extends the original mercantilist ideas to today's realities. The school's main assertion that aggressive government actions – including STRATEGIC TRADE POLICY, INDUSTRIAL POLICY and TECHNOLOGY POLICY – will bring about increased national 'competitiveness' overseas. In the United States, leading proponents of this view include such academic economists as Paul Krugman and Lester Thurow at MIT, and John Zysman and Laura Tyson (formerly chair of the Council of Economic Advisors) at Berkeley, and numerous well-known commentators, including Clyde Prestowitz, James Fallows, Chalmers Johnson, Pat Choate and Karel van Wolferen.

'Industrial policy' and 'strategic trade policy' differ from one another in some respects. Industrial policy focuses on the development of

key domestic industries and technologies, with international trade accorded a secondary role. Strategic trade policy focuses on international trade, on promoting specific exports and limiting specific imports. Strategic trade policy includes, as well, the use of threats and the imposition of penalties to pry open foreign markets. A recent example is the US threat to impose high countervailing tariffs on Japanese imports – by reactivating the SUPER 301 provision of the trade legislation of 1988 – unless US exports of cars and auto parts reach certain specified shares of Japan's domestic market for these products.

Nevertheless, despite the differences between strategic trade policies and industrial policies, they share a fundamental premise: government should select certain industries, technologies and firms whose advancement is of 'critical' importance for the economy as a whole, and accord the selected ones some form of preferential treatment – whether through SUBSIDIES, tax advantages, import restrictions, special efforts to promote exports, or direct government financing for 'pre-commercial development' of putatively critical technologies. To some, 'critical' means high-technology industries in general; to others, it means this as well as certain specific sectors, such as semiconductors, or telecommunications, or cars, or machine tools, or even rice. In the interest of simplicity, both sets of policies are often referred to as 'preferential industrial and trade policies' (PITP).

The intellectual basis for PITP rests on several well-established economic precepts: first, ECONOMIES OF SCALE – the notion that large firms can realize certain efficiencies not accessible to small ones – and, second, economies of learning – the notion that individuals and firms that have acquired abundant experience are more efficient than those with less.

A corollary of these gains is the existence of certain spill-over benefits (EXTERNALITIES) that are presumed to accrue to other industries or to the economy as a whole. These externalities – benefits external to the firm or industry generating them, and not susceptible to its

control or exploitation – may be of several types and may arise in various ways. For example, if a firm or industry achieves substantial size, it may provide a large market that redounds to the advantage of feeder industries, firms and suppliers. Thus the large size of the automotive industry provides opportunities for electronics, tyre, lighting and other component producers that, in turn, enable them to increase their own efficiency through larger-scale production. Economists refer to these spill-overs as 'pecuniary externalities'.

Another type of spill-over – referred to as 'technological externalities' – may result from the experience, learning and accumulated know-how of the originating firm or industry, and the more highly skilled labour pool that is thereby created, with potential benefits for other firms or industries. The development and remarkable growth of the internet, as a result of linking computers and telecommunications, provides a striking example of technological externalities that hugely benefit international business, finance and commerce.

Economic realists often assert that in such technology-intensive industries, costs fall and product-quality improves as the scale of production increases, and the returns to technological advance create beneficial spill-overs for other economic activities. Economies of scale are typically represented by unit costs that decline as the scale of output increases. Economies of scale are traceable to the increased opportunities of large firms for division of labour and specialization of tasks, and for spreading fixed costs over a larger volume of output as production rises. Thus, supermarkets typically can under-price small grocers and profit from doing so. And, at least until recently, it has been presumed that large-scale steel-makers, such as USX or Kobe, can out-compete small steel producers because of the economies of scale the larger firms can realize.

'Economies of learning' – that is, efficiencies resulting from accumulated experience – are also presumed to result in lower costs, and to yield a competitive advantage for firms that have been in business for a long time.

Economists use various proxies to measure experience: for example, the cumulative output of individual firms or the cumulative years they have been in business. The premise underlying these proxy measures is that the greater the cumulative output or the greater the number of years of experience, the more proficient will be the firm's operations and the stronger its competitive position relative to less experienced firms. Thus IBM, General Motors and Toyota have been presumed – at least in the past – to derive a competitive advantage from their accumulated learning and experience.

Economies of scale and learning, plus the corollary externalities with which they are associated, provide the intellectually respectable ideas that have led many to accept the case for strategic trade and industrial policy. Because of these economies, it is argued, government should establish one or another type of preference or subsidy to establish a lead in an industry, and once this lead is established it becomes self-reinforcing and tends to persist.

Criticisms

From the discussion above it might appear that adaptation of the lessons of economic realism to modern economic problems would be fairly straightforward. As noted above, economic realists begin with the notion that economic activity is a source of power and, in a world in which military conflict between major states is unlikely, economic power will be increasingly important in determining the primary or subordinate states. Still, the strong theoretical arguments in favour of preferential industrial and trade policies confront equally powerful arguments in opposition. PITPs are also criticized for normative, empirical, as well as theoretical reasons. Large size and accumulated experience confer initial advantages, but may entail later, offsetting disadvantages. This suggests there may be an optimum size – large, but not too large – and an optimum degree of experience – some, but not too much – for maximum competitiveness. While some scholars attribute the recent economic success of Japan and the NEWLY INDUSTRIALIZED COUN-

TRIES (NICs) of Asia largely to PITPs, others attribute it to low wage and inflation rates, rapid copying of the product and process technologies of competitors, high domestic savings rates (enabling low interest and high investment rates) and undervalued currency exchange rates, to name just a few of the possible alternative explanations.

The normative critics focus on the dangers of giving too much power to the state. Classical liberal and neo-classical economists argue that the state should be restrained from asserting its authority in new areas of the economy unless there is no other way to resolve market failures. Critics question particularly the need for strategic intervention to increase economic welfare. Consider a situation in which a state identifies a set of strategic industries and provides them with an export subsidy. Suppose that such strategic industries compete for the same scarce factors. In this case, state support drives up the prices of the scarce factor (a pecuniary externality) and none of the industries benefit. Furthermore, if equity is also an objective of state policy, then such interventions will skew the income distribution in favour of the scarce factor.

Critics also point out that PITPs can advance the interests of a particular country only if other countries do not retaliate by providing matching supports to their domestic firms and industries. If such retaliation occurs, then the relative gains promised by PITPs may not materialize. It is also suggested that special interests will abuse the willingness of governments to intervene. Firms, as rational actors, have incentives to externalize their problems to avoid painful internal restructuring. Such firms can therefore be expected to lobby for state support. It will therefore be difficult to separate strategic interventions from non-strategic interventions.

Many scholars question the ability of governments to effectively implement PITPs. They consider PITPs to be similar to infant-industry and import-substitution policies (see IMPORT SUBSTITUTION; INFANT INDUSTRY PROTECTION), encouraging rent seeking and leading to misallocation of resources. One of their

concerns is that it is difficult, *ex ante*, to specify which industries are strategic. That is, in part, related to the difficulties in measuring externalities. In the absence of reliable objective measures of externalities, political rather than economic criteria may dominate the choice of strategic industries.

Strategic innovations have to be focused on industries with super-normal profits and states often have only limited ability to identify such industries. Furthermore, it is difficult to determine whether a particular level of profit is super-normal. Imperfect competition also does not *per se* signal super-normal profits, since competition among a few rival firms can be fierce enough to drive the prices down to competitive levels. Also, PITPs require that the national firms be clearly distinguished from foreign firms and that policies be targeted to benefit national firms only. However, in a global economy it is often difficult to distinguish between national firms ('us') and foreign firms ('them').

PITPs are most effective in creating competitive advantage if technology is not mobile across national boundaries. However, technology flows across national boundaries are growing with the help of innovative institutional arrangements such as joint research ventures, technology exchange agreements, customer-supplier relationships and so on. Critics argue that PITPs cannot explain how domestic firms become R&D leaders in the absence of government assistance, or how state-assisted industries failed in the face of massive assistance. Hence, they argue PITPs can at best be only facilitating conditions for the success of domestic firms.

Scholars also point out that there are different forms of capitalism and that only some forms are consistent with strategic interventions. An important research question is whether some countries are more willing and capable of using PITPs than others. The United States has rarely engaged in strategic interventions in the past, partly because of the ideological and institutional acceptance of neo-classical economics. On the other hand, since neo-classical ideas are less influential in Japan,

the Japanese state faces less opposition to its interventionist role.

PITPs do not show instantaneous results: their effects are usually visible after considerable time-lags, sometimes longer than electoral cycles. The successful implementation of PITPs requires that firms believe that state support will continue irrespective of political change. Can every state make such credible commitments? If we classify states as regulatory or developmental, it is usually conceded that regulatory states have minimal capabilities for strategic interventions, and their policies seek to ensure an unfettered working of markets and a correction of market failures wherever they arise. DEVELOPMENTAL STATES, by contrast, are capable of adopting PITPs and are willing to stick with them, even in the face of temporary difficulties.

The nature of domestic socio-political institutions – such as the relative autonomy of the state from domestic interest-groups, the transparency of domestic decision-making, and social and political cohesiveness – critically shape firms' perceptions of state commitments. For example, if political power is dispersed domestically, then it may be difficult for the government to make credible commitments. In a relatively decentralized federal system, the executive may face strong opposition from provincial governments, as well as from the national legislature and competing bureaucracies, and therefore may not be able to sustain its interventionist policies. Thus one would expect countries with centralized and bureaucratic (and therefore relatively autonomous) political regimes to be more likely to adopt and sustain PITPs.

Are developmental states always more credible in providing such assurances or are they credible only in some phases of economic growth? Here the literature identifies four phases of ECONOMIC GROWTH: factor-driven, investment-driven, innovation-driven and wealth-driven. PITPs are linked with the investment-driven phase, in which the developmental state actively facilitates economic growth. State support may in fact constitute a credible commitment to deter foreign competitors from engaging in predatory strategies

such as reducing prices to drive domestic competitors out of business. However, in the innovation-driven phase of growth, the micro-management of the economy of the developmental state is counter-productive, since bureaucrats seldom have the information needed to correctly pick winners. In this phase, the regulatory state (which does not undertake PITPs) may provide a more appropriate institutional setting, since it focuses on providing macro-economic stability, guaranteeing INTELLECTUAL PROPERTY RIGHTS (IPRs) and preventing inefficiencies caused by imperfect competition.

Alternative neo-mercantilist agendas

The objections to PITPs noted above suggest neo-mercantilist policies focused in this direction may not be appropriate for many countries. This being the case, economic realism will have to be tailored to fit individual economies and situations before it will gain wide acceptance in the academic and policy communities. In addition, it appears that a number of macro-economic initiatives may be more effective than micro-economic initiatives or related PITPs at attaining the economic realist's national objectives. For example, looking at the United States, Theodore Moran (1993) asks: what economic policies will in fact foster the pursuit of primacy? What economic policies would, in contrast, lead to the redistribution of power in favour of rivals of the United States, complete with the hostility and antagonism of earlier big power struggles? In short, what is the economics agenda best suited for an economic realism approach to policy-making? Is there a special policy-path, perhaps built around strategic-trade theory, for those who wish to pursue relative gains at the expense of mutual gains, or political power at the expense of economic welfare?

Writing in the early 1990s, Moran suggested that an economics agenda for US neo-realists should address three principal dangers to that country's position in the international political system that emerged directly from US economic policy: a persistent imbalance in trade

and capital accounts that mortgaged the assets of future generations or turned the assets of the current generation over to foreigners; a lagging competitiveness of firms and workers that undermined the growth rate and skill level of the nation's industrial base (and other sectors) in comparison to rival states; a growing dependence on outsiders for critical products or technologies, which left the nation vulnerable to denial or manipulation by external suppliers.

The neo-mercantilist approach would approach balance-of-payments disequilibrium by attempting to force other nations to open their markets, or pushing especially forcefully for domestic controls on investment flows. However, as Moran correctly notes, the method to stop the foreign build-up of obligations against US assets is, despite the appearance of the words 'trade' and 'investment', purely a macro-economic issue involving domestic consumption versus domestic savings. As long as a country consumes more than it produces, it will experience a trade deficit and a corresponding reliance on foreigners to finance it. Trade protection and investment restrictions, strategic or otherwise, cannot alter this; neither can vigorous efforts to open up external markets for products of capital. Trade policies and regulations for investment can affect the composition of the imbalances, but not their magnitude. Change in magnitude can only be accomplished by altering the country's internal consumption/savings ratio.

The second threat to America's position in the international system – weak growth in the performance of American firms and workers in comparison to the corresponding growth in the performance of foreigners – also calls for a inward-oriented macro-economic solution – increasing indigenous investment in plant and equipment, human capital and new technology.

With regard to the neo-realists' final objective of avoiding dependence on foreigners for critical products and technologies, exclusive use of strategic trade policies might also be somewhat self-defeating, leading to provocation, escalation and retaliation from the major industrial nations. Specifically, an approach

that consciously uses market intervention to capture a significant share of the most vital high-tech industries for one's own country, if legitimated for any particular state becomes a fair game for all states. Instead, a neo-realist agenda might consider mixed-nation participation in public R&D programmes, regulation of foreign acquisitions in critical industries via performance requirements for local production (not prohibition of the acquisition itself), encouragement of transborder corporate alliances and harmonization of anti-trust surveillance (competition policy) across national jurisdictions. Here the goal would be to diversify sources of supply in crucial industries whose structural characteristics lead naturally to concentration.

Doubtless there are other mixes and variations to this approach. With some fine-tuning, however, the measures outlined hold out the promise to activist policy-makers that the tools exist to strengthen the relative power and influence of a country, while at the same time preserving reasonably stable relations between the various industrial challengers. In this sense, advances in economic realism and neo-mercantilism offer governments hope that they can affect their country's fate rather than casting it to the free-market winds.

See also:

economic nationalism

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ROBERT LOONEY

economic regions

Economic regions are made up of a limited number of states, counties or cities which share a common geographical space and which are economically interdependent to varying degrees (see INTERDEPENDENCE). Economic regions may take many forms, from supra-national regional trading blocs such as the ECONOMIC COMMUNITY OF WEST AFRICAN STATES (ECOWAS) to supra-continental economic regions such as the newly created ASIA-PACIFIC ECONOMIC COOPERATION FORUM (APEC). Economic regions more commonly refer to sub-national economic regions organized around particular industry clusters, such as the industrial districts of Tuscany or 'technopoles' (Castells and Hall, 1994), such as the Silicon Valley in California.

Economic regions are playing an increasingly significant role in international political economy (IPE). Theorists such as Ohmae (1995) argue that the decline in the influence of nation-states and the GLOBALIZATION of the world political economy has led to the increase in importance of both supra-national and sub-national regions. While supra-national economic regional associations, in the form of trading blocs or development initiatives, have

long played a part in the global economy, the re-emergence of economic REGIONALISM at the end of the COLD WAR is different from previous waves of regionalism because they are truly global in reach (Fawcett and Hurrell, 1995). Processes of globalization have been accompanied by a simultaneous localization of the world economy (see LOCAL-GLOBAL NEXUS). The increasing importance of economic regions as well as new regional localities, such as EXPORT-PROCESSING ZONES (EPZs), challenge the traditional state-central understandings of IPE. As economic coordination becomes increasingly globalized, the key interaction among firms has become localized or regionalized.

Whereas much of the attention of regional studies in the past has focused on industrial complexes centred around industries such as coal, steel or textiles, now much of the focus of regional studies has shifted to high-technology regions or 'regional innovation systems' (Braczyk *et al.*, 1998). While industrial regions reflected Fordist forms of centralized production, these new high-technology regions or 'technopoles' reflect new, more flexible forms of production. Moreover, while industrial districts were largely confined to a particular territorial nation-state, these new economic regions are more globally integrated.

See also:

local economic development (LED)

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NICOLE LINDSTROM

economic summits

GLOBALIZATION of economics and LIBERALIZATION of currencies have together intensified stresses in the management of the world economy. Notwithstanding the continuing evolution of global governance (see GOVERNANCE, GLOBAL) for the world marketplace – from the International Bank for Reconstruction and Development (IBRD) (see WORLD BANK) and INTERNATIONAL MONETARY FUND (IMF) to the WORLD TRADE ORGANIZATION (WTO) – a series of less formal and less than universal arrangements have emerged in response to apparent deficiencies and instabilities. Longer-term non-state fora include the 1970s Trilateral Commission across North Atlantic and the

North Pacific and now, since the early 1990s, the more global World Economic Forum.

The pre-eminent official structure since the mid-1970s has been the summit of the GROUP OF 7 (G-7) leading industrial democracies, which has been extended to include Russia in some of its deliberations. The G-7 has gradually evolved from a relatively informal discussion to a more formal and extensive rolling structure, with the host serving as the secretariat for one year. It has also enlarged its focus from economics to security and GOVERNANCE, so that its economic and political declarations now include new security issues, like the proliferation of conventional weapons and small arms, and governance questions, like democratization, elections and civil societies. It has also spawned subgroups of finance ministers, who meet on a more regular basis between each summer's summit, particularly if an economic crisis requires attention, such as the Asian and Russian crises in mid-1998.

In addition to standard features and responses to current crises in the annual 'summit communique', each G-7 summit now produces a 'chairman's statement' which reviews the global scene, from pressing world issues to an overview of major regional situations.

The twenty-first such summit – which was held in Halifax, Nova Scotia, in June 1995 – marked the end of the third cycle: that is, all members have hosted the summit on three separate occasions (Ostry and Winham, 1995). In mid-1996, the G-7 met in Denver, Colorado, and in mid-1997 in Lyons, France. In mid-1998 it was the turn of Birmingham, in the United Kingdom. Thus far, the fourth cycle has been concerned with ongoing reform of multilateral financial and political institutions, and with security and stability during transitions in Eastern Europe. The G-7 meets at the start of each summer, with the International Financial Institutions (IFIs) meeting in late summer and the UN's annual General Assembly convening each autumn.

The G-7, like the annual meetings of the IFIs, has generated counter-conferences of non-state and -corporate groups in civil society: 'people's summits'. The parallel NGO

meetings track the same agenda as government leaders, but reflect divergent interests and proposals, especially on issues of international debt and development. That in mid-June 1995 lead to the 'Halifax initiative' on global debt, which continues to be a yardstick against which to monitor official responses from states in the North. It also focused on reform of the UN and IFI systems, and the desirability of a 'social clause' in the WTO. Its potential for articulating and organizing 'counter-hegemony' is reflected in successful global coalitions in the 1990s on such issues as biodiversity, child labour, land-mines, ozone-depletion and women's development, culminating in the defeat of proposals for a Multinational Agreement on Investment (MAI).

In the late 1990s, the global coalition in opposition to the WASHINGTON CONSENSUS intensified its demands in G-7 and related fora for debt cancellation for the poorest – the Jubilee 2000 Campaign – and related issues of improved terms for relief for the HIGHLY INDEBTED POOR COUNTRIES (HIPC)s (three-quarters of whom are in sub-Saharan Africa), along with containing and overcoming Africa's conflicts.

In response to the demise of UNITED NATIONS CONFERENCE ON TRADE AND DEVELOPMENT (UNCTAD) as their preferred high-profile forum, as well as their own difficulties in dealing with such INTERNATIONAL NON-GOVERNMENTAL ORGANIZATIONS (INGOs), major states in the South have come to arrange their own version of the G-7: the Group of 15 (G-15) major developing economies other than the NEWLY INDUSTRIALIZING COUNTRIES (NICs) (including Brazil, India, Indonesia, Mexico, Nigeria and South Africa). The G-15 group has met occasionally in response to economic crises such as debt, exchange rates and negotiations over agricultural and industrial products.

The global timetable includes several similar summits every year or two, such as those hosted by the ORGANIZATION OF PETROLEUM EXPORTING COUNTRIES (OPEC), the Commonwealth and Francophonie, as well as the EUROPEAN UNION (EU) and NORTH ATLANTIC

economies of scale

TREATY ORGANIZATION (NATO), some of which attract NON-GOVERNMENTAL ORGANIZATION (NGO) attention and participation. Moreover, during the last couple of decades there have been a series of UN-related global conferences on topical issues, such as the environment, land-mines, social development, urbanization and women. These have often entailed parallel NGO forums and inputs, leading to notions of global coalitions or governance (Wapner, 1996). They have, however, rarely achieved the degree of sustained attention and orchestration achieved by the G-7.

See also:

Group of 3 (G-3); Group of 5 (G-5)

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TIMOTHY M. SHAW

economies of scale

Economies of scale relate to certain features of technology and the organization of production which have major implications for the economic, political and geographical concentration of power and wealth, especially since they can make more likely the rise of MONOPOLIES, INTEGRATION through trade, TRADE BLOCS and WORLD CITIES. Economists distinguish between internal and external economies of scale, the

former relating to a firm or factory/branch and the latter to a cluster of firms in a geographical region. When large-scale production plants go with lower average costs per unit of output (compared to a smaller plant) they exhibit (internal) increasing returns to scale. They are internal – to the firm that controls the plant. More advanced technology may require large plants. Big plants may also achieve scale economies due to more elaborate specialization within the plant. A large multi-plant firm may benefit from economies of scale in buying inputs in bulk, in carrying out research and development (R&D) and in managing financial assets. Such advantages imply that in some industries both the most efficient (optimal) scale of production and also the optimal size of firm may be very large. Given limits to the size of the market, only a few big firms may survive, resulting in an OLIGOPOLY. New entrants will be deterred by the scale of capital investment required. The establishment of some industries in developing countries is made more difficult – unless they can get investment by transnational corporations (TNCs) (see MULTINATIONAL CORPORATIONS (MNCs)). The competitiveness and MARKET POWER of such corporations is often founded on reaping scale economies, allied to advanced technology and managerial organization. The growth in firm-size might be limited if there are managerial DISECONOMIES OF SCALE due to the bureaucratic complexity of transnational multi-plant firms.

If many industries are dominated by a few firms then this can affect the balance of power between capital and labour, and between government and business. For example, MARX thought that TECHNOLOGICAL CHANGE was biased towards large-scale production, so that capital was increasingly concentrated in the hands of big firms and their owners, with a decline in numbers of small businesses and the self-employed. Hence society was becoming increasingly polarized between two classes, workers and capitalists, with growing inequality. Further, since large-scale production required a big market, the search for export markets was intensifying, contributing to the growth of an integrated capitalist world econ-

omy and to aggressive trade policies. On the other hand, national labour unions in the older industrialized countries found it easier to increase UNIONIZATION in the first two-thirds of the twentieth century, partly because potential members were increasingly concentrated in a few large plants and districts.

External economies of scale (see AGGLOMERATION ECONOMIES) arise when the scale of clustering of rival firms in a region or district stimulates the growth of specialized services – such as financial and training institutions, and firms supplying parts – with the result that external costs (of inputs) fall. Hence a region's COMPARATIVE ADVANTAGE can be reinforced. In the late twentieth century, the regional/industrial policies of governments became increasingly focused on promoting such clusters (especially high-technology ones) by means of grants, good infrastructure and relatively light regulation.

See also:

imperialism; monopolies; strategic trade theory; trade policy

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DAVID LAW

economies of scope

A single firm can reduce average costs of production of two or more goods or services by use of the same technology, employing identical technology in the production of differentiated output. While ECONOMIES OF SCALE imply a certain level of specialization and standardization in tastes and in production, economies of scope deal with diversity in output and tastes. Economies of scope allow firms to respond swiftly to changes in the supply of inputs and shifts in demand, because

these economies come from the common control of distinct but interrelated production activities. For example, the same kind of fabric and sawing machines can be used in the production of various goods, or the same type of aircraft can be used for the transport of both cargo and passengers.

MIROSLAV N. JOVANOVIĆ

economism

Economism is the term used to describe approaches to international political economy (IPE) that reduce explanation to narrowly defined economic factors and/or eradicate human agency from the theoretical framework. Few theories are wholly economistic in ruling out all consideration of the role of human beings, although some theoretical frameworks demonstrate tendencies to economism. Economism, however, because it implies a one-sided view, is a term that has negative implications. Economistic explanation can be found in work informed by modernization theories characterized by technological determinism (see DETERMINISM; MODERNIZATION THEORY). One theory frequently, but mistakenly, dismissed as economistic is the Marxian historical materialist explanation of capitalist society (see HISTORICAL MATERIALISM).

Technological determinism understands the modern world as being inexorably led by technological development over and above the decisions taken by individual human beings, or irrespective of the social structures within which the objectives of technological change are shaped. Technological determinist theories often understand the improvements and advances in technological knowledge as leading inevitably towards some better society in the future.

Marxist theories are sometimes understood as economistic because of their focus on RELATIONS OF PRODUCTION as the key analytical variable in understanding any historical epoch. For KARL MARX, production was certainly key; however, it did not refer just to the processes involved inside a particular

effective rate of protection

factory or industry, but was a much broader concept designed to describe the myriad of social activities involved in the reproduction of all social life. What is fundamental to each historical epoch or *MODE OF PRODUCTION* is the necessity for all human beings to labour to reproduce their social environment, thus 'human labour' for Marx includes a very wide range of human activity, from unpaid child-rearing through to salaried employment in large workplaces.

Marx also understood capitalist relations of production as being unique in that the competitive pressures on capitalists to increase labour's productivity gave enormous incentives to technological innovation. Rapid technological advance did not therefore have an independent dynamic of its own. It was spurred on by the specific dynamics of the prevailing relations between social groups (capitalists versus capitalists and capitalists versus workers) that characterized specifically capitalist relations of production.

Marx attempted to explain how human beings were made to appear as little more than exchangeable commodities within capitalist social relations. He wanted to demonstrate that such conditions of alienation were not natural or inevitable and to investigate ways in which they could be overcome. An interpretation of Marxian theory as economistic, therefore, ignores the social basis of his interpretation of *CAPITALISM*. Stalinism, on the other hand, is economism par excellence.

See also:

neo-Marxism

HAZEL SMITH

effective rate of protection

The 'effective rate of protection' is a measure which takes into account the rates of protection on both final and intermediate inputs. Higher rates of protection on inputs make them more costly and thus reduce the 'effective' protection

for goods higher up the production chain. The measure is useful as an indicator of the income distribution and resource allocation effects of protection. A sector with a high effective rate receives a greater income benefit from protection than a sector with a lower effective rate. Resources are drawn from sectors with low rates of effective protection to those with higher rates. Thus, the structure of effective rates of protection across sectors tells us which sectors are most highly protected by a system of trade barriers.

To illustrate how the effective rate is calculated, suppose a country's footwear industry is protected by a 25 per cent tariff on imports of shoes. In this case, the so-called nominal rate of protection on shoes is 25 per cent. Suppose a pair of shoes which can be imported duty-free for \$100 is made from leather which can be imported duty-free for \$50. A tariff on leather imports will increase the cost of this input and so reduce the effective protection for shoes. If the tariff on leather is 30 per cent, the effective rate of protection equals the tariff paid on a pair of shoes (25 per cent of \$100) net of the tariff paid on the leather input (30 per cent of \$50) as a percentage of value added in the absence of tariffs $(100 - 50)$. Thus, the effective rate is $(25 - 15)/(100 - 50) = 10/50 = 20$ per cent, which in this example is less than the nominal tariff rate on shoes. If the tariff on leather is sufficiently high (in this case, greater than 50 per cent), the effective rate of protection will be negative.

When quantitative import restrictions are used (see *IMPORT CONTROLS*), the usual practice is to compute a 'tariff-equivalent' of the quantitative restriction and use that in the effective protection formula. Calculation of effective rates can be difficult, requiring knowledge of input output coefficients for intermediate inputs in each sector, as well as the full structure of nominal tariff rates. It is therefore not surprising that measures of effective protection have not been calculated for many countries. Where available, they tend to be for only one or two years. Finally, it should be noted that although effective rates reveal the incidence of protection across sectors (and thus

the pattern of political favours), nominal rates of protection on final goods are a better indicator of the effects of protection on economic welfare (see WELFARE ECONOMICS).

See also:

commercial policy (CP); tariffs; trade policy

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NEIL VOUSDEN

efficiency

In modern social science usage, 'efficiency' refers to a ratio between inputs and outputs, costs and benefits, effort and results. An action is 'rational' or 'efficient' to the extent that it maximizes goal-satisfaction with a given expenditure of effort or to the extent that it achieves a given level of goal-satisfaction with a minimum of effort. Efficient action and rational action are thus different labels for the same phenomenon.

Contrary to popular belief, everyone (in so far as they act purposefully) desires to be efficient. Even lazy people who just want to enjoy doing nothing want to do so efficiently. Any goal can be pursued efficiently or inefficiently.

Four common fallacies in thinking about efficiency are:

- 1 *The fallacy of equating efficiency with effectiveness.* When the terms effectiveness and efficiency are used interchangeably, costs (or inputs) are ignored. Efficiency refers to the

ratio of costs to effectiveness.

- 2 *The fallacy of incomplete specification.* It is senseless to speak of efficiency in general or in the abstract. An action can be described as efficient only with reference to a specified or implied goal. The observation that Bloggs is efficient has no meaning until one specifies the goal to which one is referring.
- 3 *The fallacy of misplaced quantification.* It is sometimes implied that efficiency refers only to physical activities or to activities measurable in terms of money. Efficiency, however, is applicable to any valued input or output, regardless of the ease of measurement.
- 4 *The production–distribution fallacy.* It is sometimes implied that efficiency is applicable only to production and not to the distribution of values. Distributive goals, however, may be pursued efficiently or inefficiently.

Efficiency is thus a frequently misused and misunderstood concept. It is nevertheless highly useful for describing purposeful behaviour.

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DAVID A. BALDWIN

egalitarianism

Egalitarianism is the theory associated with EQUALITY. Egalitarianism is also closely associated with SOCIALISM. While not all socialists

would describe themselves as egalitarians, most avowed egalitarians would accept an allegiance to some form of socialism. Equality is seen as one of the core principles or values of socialism by a variety of writers. There are differences between egalitarians about where they believe the focus of equality should be placed: should it be on income and wealth, on power, on status, on condition or on some complex combination of these and other forms of equality? There are also differences about the role of equality of opportunity in an egalitarian society. Some support the view that egalitarianism involves a commitment to broad equality of benefits (or amenity) and burdens between individuals in society. Others argue that an egalitarian society involves the achievement of equality of opportunity.

Egalitarianism is supported by a spectrum ranging from certain Marxists, on one hand, to social democrats, on the other. In many ways, equality became the defining feature of Western social democracy in the 1950s and 1960s. This involved an emphasis on redistribution, rather than on production. For writers like Anthony Crosland (1956), socialism was no longer primarily concerned with the socialization of the means of production, but should involve redistribution of the economic product through progressive taxation and high levels of social spending. Among modern social democrats, however, support for the redistribution of wealth and income is often replaced by a commitment to the advancement of meritocracy, primarily through the development of improved educational opportunities and education/training provision, which are also seen as promoting competitiveness in the global economy.

While the roots of egalitarianism can probably be traced back to antiquity, for some writers egalitarianism was fatally wounded by the collapse of 'actually existing socialism' in the post-1989 period. For some, the experience of Soviet COMMUNISM showed that an egalitarian society was unsustainable, economically inefficient and necessarily resulted in oppression and the denial of individual liberty, against which people will eventually rebel.

Egalitarianism is also seen as incompatible with a competitive globalized economy. However, efforts have been made recently to devise models showing how late twentieth- and early twenty-first-century Western capitalist societies might be changed in an egalitarian direction. One such model has been advanced by the analytical Marxist, John Roemer. In *A Future for Socialism* (1994), Roemer develops the idea of a 'coupon' or 'voucher' variant of MARKET SOCIALISM. Roemer aims to promote egalitarianism in the sense of equality of opportunity for self-realization and welfare, political influence and social status. Under his scheme, all individuals within a society would have the right to coupons of a certain equal value in productive assets (capital) which would be used to gain shares in businesses. While shares would be tradable, they would not be transferable and could not be turned into money which could be used to buy goods and services. Individuals could not liquidate their shares and shares could only be bought with coupons. In that way, Roemer argues, the means of production would be brought under a form of public ownership and the inequalities which spring from the private ownership of productive forces would be eliminated. Major moves would be made towards the achievement of an egalitarian society, it is claimed.

However, Roemer's scheme would not create complete equality. For while broad equality of wealth would result from his proposals, inequality of income would not be prevented. Individuals would not receive the same incomes in Roemer's scheme, though he is not opposed to the progressive taxation of incomes and supports taxes on estates. Roemer would allow foreign investment, though the degree of this investment and the rights of investors would be controlled by domestic law. Indeed, Roemer's scheme, while avowedly egalitarian, is open to criticism from an egalitarian perspective from those who argue that equality of power is an essential element of an egalitarian approach. Roemer does not call for equality of power within business organizations. Indeed, he argues that, in his scheme, banks who provide finance for businesses should take a bigger role

in the management of businesses they help financially. In that way, Roemer suggests, the efficiency of businesses would be enhanced. For Roemer, businesses would continue to operate in competitive markets and would still strive for profits. For some, such a reliance on the competitive market and the profit motive would be incompatible with the democratic involvement demanded by a commitment to egalitarianism.

See also:

capitalism; industrial democracy; Stalinism; state socialism

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PETER MCLAVERTY

Eichner, Alfred S. (1937–88)

Alfred Eichner was an important contributor to US post-Keynesianism (see POST-KEYNESIAN ECONOMICS). Along with Paul Davidson, Jan Kregel, Hyman Minsky, Basil Moore and

Sidney Weintraub, Eichner laid the foundations for this particular school of economic thought. Kregel himself notes that Eichner's main contribution was the integration and synthesis of his own work with that undertaken at the University of Cambridge (see CAMBRIDGE SCHOOL) in the 1960s.

This activity produced a highly productive interaction, which eventually brought about what better be called a neo-institutional or neo-evolutionary synthesis with Keynes's economics, but which is now best known as post-Keynesian economics.

(Kregel, 1990: 523)

While post-Keynesians are a rather diverse group of economists, Eichner shared their common belief that modern macro-economics neglects many of the most central elements of the *General Theory* of JOHN MAYNARD KEYNES. In particular, Eichner advanced the notions that (1) the distribution of income between profits and wages plays a critical role in affecting consumption and investment decisions; (2) expectations, together with profits, are the chief determinant of investment plans, and (3) institutional features – credit constraints on households and self-finance by firms, as well as the financial structure involving credit creation in a pyramid – interact in shaping the business cycle and, on occasion, financial crisis.

The implications of these concepts were originally laid out in Eichner's 1976 work, which was subsequently refined (Eichner, 1976; 1987). According to Eichner's analysis, a deficit in the government budget implies a surplus in either the megacorp sector or the competitive sector. The stimulative effect of the deficit will soon be wiped out by the surplus in either or both of the other two sectors, so that if the government wishes to achieve a higher level of income, it will be faced with a mounting deficit and debt, a situation that cannot possibly be sustained.

Eichner's view was that the surplus of the megacorp sector would be most pronounced, given that the high level of aggregate demand

embedded financial orthodoxy (EFO)

will inevitably lead to increasing rates of capacity utilization and consequently a disproportionate increase in cash flows. If, however, the megacorp sector were prepared to increase their investment or decrease savings, a higher level of output could be achieved without the government having to resort to unacceptably high levels of deficits and debts. Eichner was not optimistic about this happening or in the ability of government economic policies to eliminate the surplus in the megacorp company.

In his view, government deficits (along with some form of incomes policy) could potentially move the economy to and maintain it at full-employment level of activity. However, in an open economy the budget deficit will lead to a deficit in the BALANCE OF PAYMENTS with the ensuing balance-of-payments crisis necessitating a reversal of the expansionary policies. In other words, Eichner noted that in open economies there is tendency for balance-of-payments problems to undermine attempts at achieving full employment – the result is the problem of stop-go policies that particularly plagued England in the 1960s and 1970s.

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ROBERT LOONEY

embedded financial orthodoxy (EFO)

The expression 'embedded financial orthodoxy' (EFO) was coined by Philip Cerny, who

used it to refer to a situation in which 'economic production and exchange is shaped first and foremost by financial and monetary imperatives' (Cerny, 1994: 226). Cerny's contention is that EFO has replaced the post-war 'embedded liberal regime'.

The key contrast between the emerging EFO and EMBEDDED LIBERALISM is that, while in the latter state intervention to protect society from the disruptive effects of international markets was considered legitimate and necessary, in the EFO it is the orthodox understanding of states and markets that prevails. In embedded liberalism, FREE TRADE was considered beneficial. However, international markets (particularly financial markets) were analysed as potentially disruptive and ineffective. This made the construction of the WELFARE STATE seem legitimate. International liberalism was 'embedded'. By contrast, EFO reflects an orthodox view of markets as the most efficient means for distributing resources. MARKET FAILURES are minor compared with state failures. Consequently, the role of the STATE becomes one of 'embedding' the narrow set of orthodox policies acceptable to financial markets.

The EFO emerged gradually in the 1980s as the result of structural changes, particularly the GLOBALIZATION of financial markets. This trend was reinforced by the perceived failure of KEYNESIAN ECONOMIC policies to deal with the prolonged economic downturn following the first oil shock and the related emergence of NEO-LIBERALISM. EFO is part of a family of expressions used to describe shifts in international regimes and in the role of states. As such, it has its place in debates concerning the nature of globalization.

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ANNA LEANDER

embedded liberalism

In an analysis based on the DOUBLE MOVEMENT concept of KARL POLANYI, John Ruggie called the post-war international system the compromise of 'embedded liberalism'. Embedded liberalism describes a continuous search for a form of MULTILATERALISM that is compatible with the requirements of domestic stability. The essence of the post-war system was that, unlike the economic nationalism of the 1930s, it would be multilateral in character; unlike the liberalism of the GOLD STANDARD and FREE TRADE, its multilateralism would be predicated on domestic interventionism (1983: 209). Liberalism continued in this compromise between international openness and the domestic WELFARE STATE, but it was embedded in the domestic social order. Ruggie argued in his constructivist critique of NEO-REALISM that embedded liberalism – as the hegemonic form of state society relations – is a constitutive principle that differentiates the post-war system from the LAISSEZ-FAIRE nineteenth-century system. International openness and domestic stability inevitably undermine each other in the absence of social rapprochement, which underlies recent fears that GLOBALIZATION is associated with a new attempt to disembed the economy or, at a minimum, with a hollowing out of the embedded liberalism compromise.

See also:

regime theory

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ROBERT WOLFE

embedded state

Despite inconsistencies in his argument, Marx undoubtedly made important contributions to the analysis of the STATE. His starting premise was that the state was the tool of the ruling class. However, after 1850, he modified his views to arguing that, in order to advance its interests, the state need not necessarily be involved in the day-to-day running of government. On another occasion ('Oriental despotism'), he also contended that the state had its own interests and programme, and this degree of independence enabled it to hold sway in the struggle between opposed classes. This is the background against which debates on state-society relations have taken place. It has been argued that, with the state assuming an ever greater role over wealth-creation and distribution and/or welfare, the question is not whether the state should be involved in these activities, but how sensitive to societal needs it should be and to what degree its ties with society aid (industrial) transformation.

Evans (1995), in particular, contends that since accumulation is (arguably) cumulative, it is incumbent on us to examine the role of the state in the global division of labour (in terms of how it is organized and interlinked with society) to enable industrial transformation to take place. By identifying desirable niches or trajectories of development (the product cycle theory), countries can indeed move up or down the linkage system. Our understanding of these possibilities can, so the argument goes, be aided by juxtaposing the 'developmental' or embedded state and the 'predatory' and 'intermediate' states.

Developmental states, such as those in Korea, Japan and Taiwan, presumably 'listen' to their people and their concerns, while also being autonomous. They have well-developed bureaucratic structures and state-society relations which bind individuals to well-defined and coherent corporate goals. The main thrust of the argument is presented by Evans in the following way:

Highly selective meritocratic recruitment and long-term career rewards create commitment

and a sense of corporate coherence. Corporate coherence gives these apparatuses a certain kind of 'autonomy'. They are not, however, insulated from society as Weber suggested they should be. To the contrary, they are embedded in a concrete set of social ties that binds the state to society and provides institutionalized channels for the continual negotiation and renegotiation of goals and policies. ... Only when embeddedness and autonomy are joined together can a state be called developmental.

This apparently contradictory combination of corporate coherence and connectedness, which I call 'embedded autonomy', provides the underlying structural basis for successful involvement in industrial transformation.

(Evans, 1995: 12)

Arguably, in the case of Japan, the state played a crucial role after World War II in directing investment capital towards industry. With its rules and established norms, and informal networks based on meritocracy and formal competence, the bureaucratic structure provided the cohesive organization required for participating in external networks (Dore, 1993). In the Korean example, on the other hand, selection for the higher civil service was, at times, marred by 'special appointments'. Notwithstanding, the necessity to allocate scarce capital forced the (Park) government to forge closer ties with big business. Thus – unlike Japan's case, where social ties with the state were well-developed – Korea's embeddedness 'was a much more "top down" affair' (Evans, 1995: 53). Finally, for Taiwan, the centralized party instilled discipline, binding party members to the pursuit of collective goals, thus reinforcing the bureaucratic structure and providing internal coherence. To the extent that private capital, by its very identification with ethnic groups, was seen as divisive, state-owned enterprises were concurrently regarded as crucial to the transformative agenda. Not surprisingly, the private sector was not

shielded from the rigours of international competition.

Throughout these examples, 'relative autonomy' is taken to mean not so much the state's mediation between fractions of capital and between the bourgeoisie and the proletariat, thus enabling it to foster capital accumulation better than private capitalists (Poulantzas, 1973), but the way in which state society relations are broadened in the interest of a transformative project. This is the context in which Evans (1995: 234–47) addresses the question of the degree of embeddedness in Austria and Kerala (in India).

The developmental state can be contrasted with the predatory state which, in the extreme case of Zaire (under Mobuto), can be described as a 'patrimonial-administrative state' which has been captured by very corrupt power elites. They ruthlessly plunder their society's resources, giving little in return. Paradoxically, because survival in these circumstances depends on consistently undermining and weakening organized groups, the state lacks the capacity and moral authority to mobilize 'the people for developmental tasks' (Callaghy, 1987: 8). Moreover, since repressive divide-and-rule policies do not fully insulate the state from attack, it increasingly relies on external allies for survival (Lemarchand, 1987).

Patron-client ties are based on personal ties and individual maximization, which undermine the collective ethos. This is in contrast to the selection process and performance criteria which distinguish the embedded state. To the extent that successful transformation is contingent on the establishment of rule-governed bureaucratic behaviour and a sense of corporate coherence, the tendency of the predatory state to weaken CIVIL SOCIETY also undercuts the transformative project (Evans, 1995).

Finally, intermediate states, as exemplified by Brazil and India, may at times help or hinder industrial transformation. These states can neither be categorized as purely predatory – since they do not exhibit the same degree of consistent (economic) decline and decay as in the Zairean case – nor can they be described as

strictly developmental – since they do not have the same degree of corporate coherence of embedded autonomy. The majority of developing countries arguably fall between two stools, with potential in certain sectors for industrial transformation, while there still remains the possibility of degenerating into chaos and clientelism.

Historical investigation suggests that the bureaucracy in Brazil is populated by political cronies: their position depends on who is in political power at the time and which new organizations are created by the incumbent government. As a result, selectivity is difficult, while expansion is uncoordinated. Piecemeal reform of the state therefore remains the only option. Nevertheless, growth and industrialization have been relatively impressive, simply because Brazil has had some bureaucratic structures (albeit ones in which only small 'pockets of efficiency' can be identified) and certain sectors of the economy have been successfully transformed (Evans, 1995).

In the Indian case, there has been a long bureaucratic tradition, with selectivity for the civil service. However, with the passing of time, there has been a perception that bureaucratic jobs are of low status. This, together with the relatively better working conditions in the private sector, has made it increasingly difficult to attract and retain the most talented university graduates. This is not helped by the complex cultural, religious and regional factors. With divisions threatening to come to the surface, the state is forced to balance its policies between different interests, particularly those of landowners and big business. This can thus limit its ability to embark on industrial transformation. Despite this, India's performance, like Brazil's, has been impressive. But, unlike Brazil, India's historical circumstances led to the fostering of state-owned enterprises at the expense of private sector initiatives. While state involvement is desirable, it must also be noted (as is the case for the developmental state) that this may create unintended consequences in the form of new social groups whose interests conflict with those of the state.

See also:

autonomous development: legitimacy crisis

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TIDINGS P. NDHLOVU

embedded statism

The concept of 'embedded statism' has two interrelated meanings. The first is the idea that the STATE has been prioritized unduly in the conduct of international relations (IR). States and their populations have, by such a view, maintained an exaggerated view of SOVEREIGNTY in principle and been excessively self-regarding in practice. Such a disposition has thus generated an excessively zero-sum view of the relations between states and inhibited the development of a wide range of desirable, and even necessary, international, transnational and supranational arrangements.

A range of theorists also claim that the concept of the state has exercised a pernicious and unwarranted influence on the academic study of IR and, indeed, on a wider range of the 'social sciences'. Academic critics of embedded statism claim that an exaggerated emphasis on the concept of state sovereignty has obscured the complexity of relationships among peoples, the nature of many contemporary developments and, indeed, acted as a shroud for more profound forces throughout modern history (for example, global CAPITALISM). Contemporary human geographers, like Peter Taylor (1996), thus argue that embedded statism underlies the assumption of sociologists and economists, as well as of political scientists and IR students, that the contemporary state cannot be simply assured to be the primary spatial structure of humanity, to the neglect of

cities, subnational regions, transborder regions and global arenas.

A further academic criticism of embedded statism focuses on its ethical implications. Such a prioritization of the national element of any state configures ethical debate about principles and practices on a global scale and, in the eyes of critical theorists, fatally disfigures such discussion.

Critical notions of embedded statism have, however, been criticized on three grounds:

- 1 the analytical argument that they exaggerate the degree to which theory and analysis has, in fact, been governed by presumptions of the primacy of the state as the sole, or dominant, spatial structure (Gamble, 1996);
- 2 the practical argument that states, individually or acting in concert, do actually continue to offer the only effective structures for public GOVERNANCE, despite their many shortcomings (Jones, 2000);
- 3 the ethical argument of communications (Brown, 1992) that established political communities, and particularly states, offer the only realistic collectivities for the creation of the patterns of mutual obligation, respect and regard that will preserve solidarity and ensure effective resources and services for their members and that can, hence, sustain genuine ethical community.

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R.J. BARRY JONES

EMMANUEL, ARGHIRI *see* unequal exchange

Empire, British

The British Empire was the largest of the modern European empires. At its height, at the beginning of the twentieth century, the British Empire encompassed possessions on six continents, and accounted for more than one-fifth of the world's land-mass and one-quarter of the world's population.

While loyalty to the British crown united all parts of the Empire, the colonies were governed in a great variety of ways. By the twentieth century, most possessions fell into four major categories. 'Dominions', such as Canada, Australia, New Zealand and the Cape Colony, had significant numbers of white settlers and were gradually granted a high degree of self-rule, although defence and foreign policy were reserved for the British parliament. 'Crown colonies', notably the Gold Coast, Nigeria, Kenya, Jamaica, Trinidad, Ceylon and Hong Kong, were ruled by the Colonial Office through a governor who might or might not be advised by representative councils. 'Protectorates', such as Egypt, Uganda and the Malay States, maintained their native rulers under the direction of the Foreign Office. 'Chartered territories', such as Rhodesia, were dependencies governed by private companies chartered by the British government. Many colonies originally fell into this last category before becoming crown colonies. India was a special case. After assuming control from the EAST INDIA COMPANY in 1858, the India Office governed the subcontinent through an appointed viceroy in New Delhi. One-third of India remained a protectorate of semi-independent princely states.

Historians also refer to Britain's 'informal' empire. Financial and naval dominance in the nineteenth century allowed Great Britain to dictate terms of trade to countries that it did not directly control. The most notable example was China, which – after losing the OPIUM WARS to the British navy and Indian army

(1839–42, 1856–60) – was forced to open its markets to opium and other products, admit Christian missionaries and submit to a permanent European military presence.

The history of the empire is commonly divided into four general phases. The 'first empire', with origins in Britain's first colony (Virginia, 1607), was characterized by mercantilist trade arrangements (including the slave trade) with North American and Caribbean colonies until the loss of the North American colonies in 1783 (see MERCANTILISM). The 'second empire' was characterized by the consolidation of Canada and India under British control, and British settlement of Australia, New Zealand, the Cape Colony and Natal. The 'classical' period of empire, after 1870, was characterized by the rapid partition of Africa and southern Asia by the European powers. The final phase was DECOLONIZATION after World War II. Britain restored Hong Kong, its last major colony, to Chinese rule in 1997.

The causes of British expansion

Scholars of political economy since J.A. HOBSON have sought to elucidate the mechanism by which economic and political motives and institutions meshed in the project of empire-building. Writers in the Marxist school have emphasized the link between industrial CAPITALISM and empire. They have focused on the role of colonial trade in igniting the INDUSTRIAL REVOLUTION, and on the key role of industrial overproduction and the search for new markets in the nineteenth century. Other scholars, notably P.J. Cain and A.G. Hopkins (1993a, b), have argued that British policy was not directed by industrialists, but was guided by the needs of 'gentlemanly capitalists', the commercial and banking elite of London who sought profitable investments and the expansion of markets for the services they provided. The Empire certainly helped to preserve the social status of traditional elites by providing dignified, non-industrial employment in the military and civil service. The complexity of political-economic motives is underscored by

research suggesting that, by the end of the nineteenth century, Britain's empire, rather than being a source of economic strength, may have cost more in terms of national income than it earned, and may also have inhibited economic innovation and development at home. Many historians have balanced economic motivations with other non-economic factors in British expansion, notably the political and military rivalry of the European powers, the racist ideologies of social Darwinism, and the enterprise of individual adventurers and missionaries.

Political economy in imperial politics

The government of the Empire was often a source of contention in British politics and emerging theories of political economy played an important role in these debates. ADAM SMITH laid the groundwork for the attack on mercantilist laws and monopolies, which led to gradual implementation of FREE TRADE policies by the 1860s. The growing popular acceptance of the principles of free trade and free labour, along with evangelical moral activism, contributed to the abolition of the slave trade in 1807 and of slavery itself in 1833. The abolition cause in turn spurred public enthusiasm for the spread of English civilization and Christianity to Africa and Asia. In the middle of the century, the explorer and missionary Robert Livingstone thrilled the British public with his explorations in central Africa and with his call to 'make an open path for commerce and Christianity'.

At the same time, 'radicals' in Parliament, led by RICHARD COBDEN, maintained that free trade would bring an end to imperialism and promote international peace and cooperation. Most British leaders believed, however, that British trade required the backing of British military strength, especially in India, China and Africa. JOHN STUART MILL defended British rule in India as a necessary preparation for eventual independence. In 1882, Prime Minister William Gladstone, although himself a champion of free trade and a critic of empire, initiated the European scramble to occupy

Africa by ordering British forces into Egypt to shore up a faltering regime heavily indebted to British investors, and to secure the strategic Suez Canal, the primary link to India.

By this time, fear of British economic decline relative to other great powers inspired new enthusiasm for empire. Advocates of IMPERIALISM – such as the Nobel Prize-winning author Rudyard Kipling, the South African diamond magnate Cecil Rhodes, and the founder of the Boy Scouts, Robert Baden-Powell – viewed empire as the means to maintain Anglo-Saxon dominance in the world while spreading the gifts of British moral, economic and political values. Imperialist idealists helped generate popular support for the South African War (1899–1902), fought to wrest control of the vast gold fields of southern Africa from Boer (Dutch-descended) settlers. In the following years, Joseph Chamberlain, the Conservative colonial secretary who helped precipitate the war, launched a campaign advocating the economic consolidation of the Empire by a system of protection and tariff preferences. The defeat of the Conservatives in 1906 indicated the British public's adherence to the principle of free trade and its refusal to embrace imperialism as the key to the British future.

Legacy of the British Empire

The legacy of the British Empire is multifaceted and profound. It occasioned significant migrations of people: white settlers to America, Australia and Africa; black slaves to America; Indians, as indentured servants, to Mauritius, Trinidad, Fiji, Natal and Kenya. It diffused Western education, Protestant Christianity and English sports. It was the means by which the English language has become the primary international language. It was, finally, an important vehicle for the creation of new nation-states and for drawing non-European peoples into the world market. These changes came at great cost to the non-white colonies. British rule may have caused significant DEINDUSTRIALIZATION, particularly in India, and contributed to endemic poverty by organizing

agriculture and infrastructure towards the production of cash crops for export. Artificial borders and the deliberate and inadvertent fostering of caste, ethnic and class divisions contributed to social conflict in ex-colonies. British RACISM and unwillingness to promote educated natives in government and professions gave rise to powerful nationalist movements that forced an end to British rule.

See also:

capital, internationalization of; colonialism; free trade imperialism; Gandhi, Mohandas Karamchand; imperial neglect and underdevelopment; imperial preference; imperial rivalry; *Pax Britannica*; post-colonialism; sub-Saharan Africa

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scholarship on the empire is presented by dozens of authors on a wide variety of topics.

CHRISTOPHER OLDSTONE-MOORE

enclaves

Enclaves are areas which are geographically part of a country, but economically cut off from it. They are most usually associated with foreign-owned export activities in DEVELOPING COUNTRIES. For example, foreign mining investments in developing countries often can be described as enclaves, since they typically buy few local inputs and employ little local labour. Enclaves are characterized by the fact that a low proportion of their export earnings are retained locally (low *retained value*). The enclave nature of many foreign-owned export activities was extreme in colonial times, particularly in mining ventures. Plantation export agricultural projects were less like enclaves, since they were highly labour-intensive, although sometimes (particularly in South-East Asia) the labour was imported. The enclave nature of foreign-owned primary production has been broken down by the ability of independent developing country governments to levy taxes on production and profits, by nationalization and by the emergence of local input suppliers, local processors and local skilled labour as economic development proceeds. At the present time, many EXPORT-PROCESSING ZONES (EPZs) function as enclaves, since they make few purchases from the domestic economy in which they are situated. The concept of enclaves was first popularized in the literature on DEVELOPMENT by the work of HANS SINGER, although it can be traced back to the writings of classical economists such as JOHN STUART MILL.

See also:

dualism; Prebisch-Singer hypothesis; structuralism

enclosures

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JOHN THOBURN

enclosures

From the fifteenth to eighteenth century, vast areas of common grazing land were enclosed by landlords and made into private property. Land previously held in common by local communities and used by villagers on a shared basis was rendered private property by erecting fences and securing title deeds through the courts. Though enclosure was sometimes effected through some level of agreement, enclosed land often became the subject of acrimonious and violent disputes. Once land became private property, its use could be mediated through the market, by charging rent for use or selling to the prospective owner prepared to pay most for it. New owners and users often ignored the traditional rights recognized by the original enclosing landowner. But, by utilizing the market to allocate this scarce resource, liberal economists regarded the likelihood of efficient use as being much greater.

There has been considerable debate about the benefits and costs of the enclosures. In a famous intervention, Garrett Hardin (1968) – referring to the TRAGEDY OF THE COMMONS – suggested that because assets belonged to no one in particular they were undervalued and thus degraded or spoiled. Enclosures encouraged private owners to ‘improve’ the land, as they could capture any subsequent rise in value. Although, in the first instance, such reward was to private owners, overall the rise in quality of land-use had social benefits. However, critics of this approach have contended that, under common ownership, much land-use was co-ordinated through non-market social institutions and the motive for enclosure was, in fact, a class-based appropriation of common assets.

This debate remains unsettled, and neither documentary evidence nor economic modelling have been able to finally offer an assessment of the balance between costs and benefits of the enclosures.

More generally, enclosures as a term has come to refer to any incorporation of the public sphere into the private field of property, of which the most discussed contemporary example is the expansion of INTELLECTUAL PROPERTY RIGHTS (IPRs). If CAPITALISM needs to expand the scope of markets to continue to develop, then the enclosure of a previously public realm has enabled this dynamic to continue. Thus, given the logic of capitalism is firmly rooted in the recognition of PROPERTY RIGHTS, those areas of social life that capitalists wish to profit from must be rendered as property. Utilizing the claim for efficient allocation of resources, and the degradation or wastage of commonly held assets, property rights are introduced. This may not involve physical boundaries, but does require the construction of a legal scarcity relative to a previous commonality. In one sense, the dynamic of enclosure is the expansionary dynamic of capitalism itself.

See also:

efficiency; industrial revolution; Polanyi, Karl

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CHRISTOPHER MAY

endogenous and exogenous money

Whether money affects price levels and national income or is instead affected by these variables is a circular argument that has been debated in monetary economics ever since the birth of the quantity theory of money in its classical form. In the classical quantity theory of money, called the 'equation of exchange', the relationship between the volume of money and the value of transactions (or the nominal value of GROSS NATIONAL PRODUCT) remains undetermined. According to this equation, either of the two factors – price (hence income) or money – can affect the other. Similar circular causality exists between price, income and money.

Take the case in which price increase raises the quantity of money. In this case, an increase in price level could have been preceded by an earlier increase in the quantity of money. In such a circular process, the exchange identity runs into a problem of definition if money remains the principal cause of price and income change. If this is the direction of the relationship, then such a relationship is exogenous from the point of view of money affecting price level and income. On the other hand, if price movements affect the quantity of money, then such a relationship is said to be determined endogenously by price level and income.

Weak monetary exogeneity occurs when the quantity of money is determined by past values of price, income and other economic variables, but remains independent of the present values of these variables. On the other hand, strong exogeneity exists when the quantity of money is influenced by both past and present values of the stated other variables. Likewise, weak endogeneity occurs when the current economic variables are affected by past values of the quantity of money, but the current quantity of money does not affect the economic variables. In contrast, by strong endogeneity of money we mean the two-way interrelationships between the quantity of money and economic variables.

In all of these cases note the importance of

treating circular causation between economic activity and the quantity of money in both past and present. The indeterminacy of the exchange equation is overcome in this case by the presence of an institutional discourse focused on arriving at a consensus on the quantity of money to generate present and future economic activity. In the institutional sense, this would mean the existence of a knowledge variable in the recursive relationship between money and real economic variables. This knowledge variable is continuously generated within an institutional framework for the purpose of controlling the quantity of money in accordance with present and future expected performance. Thereby, at a given point of time, the level of economic activity is determined by a joint distribution function made up of two conditional relations. These are, first, the conditional distribution of present real economic variables, given the knowledge input institutionally formed on the basis of such past and present variables, and, second, the conditional distribution of the quantity of money formed on the basis of present variables, given the knowledge of past variables.

See also:

money

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MASUDUL ALAM CHOUDHURY

endogenous factors

Theories use endogenous (or dependent) and exogenous (or independent) variables. An

endogenous growth theory

endogenous variable is explained within a theory. For example, the demand for corn depends on the price (and other factors), while the price of corn depends on demand (and other factors). Thus, the price is explained within the economic theory and is an endogenous variable.

See also:

exogenous factors

M. PETER VAN DER HOEK

endogenous growth theory

Since its inception in the mid-1980s, endogenous growth theory has increasingly gained ground in explaining the process of DEVELOPMENT and in generating new empirically testable hypotheses. Its implications concern not only economic growth, but also a whole range of social and political issues, such as political institutions, law and governance, education, income distribution, trade policy and research. Providing the tools to analyse endogenous technological progress and innovation in a unified dynamic general equilibrium model, it is ideally suited for studying the potential for SUSTAINABLE DEVELOPMENT.

Endogenous growth theory has been a response to the neo-classical model of exogenous growth in identifying the causative factors for long-run economic growth. While the latter emphasizes DIMINISHING RETURNS to capital, PERFECT COMPETITION and exogenous technological change, the former explains growth as a function of technological innovation within an economic system, often characterized by drives to obtain monopolistic rents. Exogenous growth theory focuses on CONVERGENCE to steady-state per capita output. In the absence of technological change, diminishing returns result in the steady-state growth rate where output, capital stock and population grow at the same rate, implying a cessation of per capita growth of output. With exogenous technological change, the increase in total factor productivity lifts steady-state output

per capita. The exogenously driven increase in productivity is, however, continually balanced by the decline of growth caused by diminishing returns, eventually leading to a new steady-state where per capita income is higher than the previous steady-state. In this context, there will not be long-run growth without continuous exogenous technological change. By contrast, challenging the explanations of long-run growth by exogenous growth models, endogenous growth theory attempts to explain the process of technological change *per se*, positing that long-run growth is determined by dynamic variables (such as innovation and ideas) *within* the model, rather than by unexplained technological progress from outside the economic system.

The fundamental conclusion of endogenous growth models is that long-run economic growth can continue indefinitely due to technological innovations within the economic system. In the endogenous model, the capital stock involves not only physical capital but also human capital, which synergetically accumulates. Knowledge SPILL-OVER allows each unit of capital investment to increase the level of technology for all firms, as well as the stock of physical capital. Such positive externalities may result in continued growth being spurred by aggregate constant or increasing returns (Romer, 1986). As each firm has only a marginal effect on capital accumulation, it is the aggregate or social effect that matters in long-run growth.

In addition, the notion of learning by doing is important for endogenous growth models: experience with production or investment increases productivity; workers may gain expertise from their work, and firms may advance their knowledge through the production process. Moreover, knowledge spill-over may occur between workers and between firms, leading to a higher level of human capital stock in the economy, improving the level of technology for each firm and enlarging the knowledge base for future generations.

The other essential source of growth in these models lies in the RESEARCH AND DEVELOPMENT (R&D) enterprise. Particularly, the pro-

spects of MONOPOLY profits compel a high level of commitment to R&D, resulting in new goods and technologies, which will raise the productivity of capital and induce additional investments. While monopolistic profits make R&D endeavours and discoveries possible, the eventual sharing of PATENTS by other producers and the diffusion of scientific discoveries that are difficult to patent will overcome previous diminishing returns in the aggregate economy, thus promoting long-run growth. Furthermore, the spread and use of these new ideas in other parts of the world contributes to global economic development.

Another strand of endogenous growth models is the Schumpeterian approach (see SCHUMPETER, JOSEPH ALOIS) which is characterized by the term 'creative destruction', meaning that growth is generated by a random sequence of quality-improving innovations that result from uncertain research activities and replace old technologies. Like the models previously summarized, the Schumpeterian model posits that monopoly rents captured from innovation are less than the consumer surplus created by the INTERMEDIATE GOODS and that invention can be used by other researchers to initiate the next innovation. Output grows continually, as intermediate goods are constantly upgraded, leading to improved productivity of the final output. Unlike the former models, however, it shows a negative spill-over in which the inventive monopolist destroys the surplus generated from previous intermediate goods by rendering them obsolete (Aghion and Howitt, 1998).

Endogenous growth theory suggests a broad range of policy levers. It affirms the impact of government policy and market incentives on technological innovation. For instance, government may provide tax subsidies for private research, offer anti-trust exemptions for research joint ventures, facilitate research activities by MULTINATIONAL CORPORATIONS (MNCs), promote acquisition of new ideas through economic openness and international integration, and assume leadership in formulating industrial strategies including employment policy to favour the high-technology

sector. In sum, endogenous growth theory presents a proactive and optimistic view of government, business and economic growth.

As is often the case with relatively new theories, the empirical evidence of endogenous growth theory remains inconclusive. One reason is that the implications of endogenous growth models are tested on the neo-classical growth framework of convergence. For instance, it has been found that within the United States and Japan, poor regions tend to grow faster per capita than rich ones, seemingly in contradiction to endogenous models. However, if the speed of convergence is determined by the rate of diffusion of knowledge and organizational determinants of the region, stronger statistics based on a direct measure of ideas and their diffusion are needed to differentiate the convergence dynamics and the spread of ideas that close the gap. It has also been found that, despite an increase in R&D, growth has been relatively constant in advanced economies. Some counter-arguments propose that increasing complexity of technology requires an increase in R&D over time so as to keep the innovation rate constant for each product and that, as the number of products increases, an innovation involving one product has direct effects on only a small proportion of the economy (Aghion and Howitt, 1998). Economic historians have shown that purposive and profit-driven technological advances were responsible for both the British industrial revolution and US economic growth since the early 1980s, though it needs further analysis to test the implications of endogenous technology through a direct measure of diffusion of ideas and technological advances.

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YI FENG

energy

Energy is the capacity to do work. It refers to the amount of force applied over a period of time. It is measured in watt/hours or in joules (one watt/hour equalling 360 joules), but it is also measured by form: barrels of oil, tons of coal, cubic metres of gas. Besides providing work through machines or appliances, energy provides heat and light. Energy is also categorized as potential (resulting from the relative position of two bodies) or kinetic (manifested by bodies in motion). For economists, energy is primary (recovered from natural resources), secondary (primary energy converted for consumers) or tertiary (amount of work actually obtained). Primary energy resources are renewable (solar and biomass) or non-renewable

(fossil and nuclear). Secondary energy is characterized by sector: residential, commercial, industrial, transportation and energy supply. Demand for energy is growing in contemporary societies, while fossil fuels like oil and gas are gradually being depleted. People use less energy when prices rise, but energy demand is not completely elastic. To avoid the predicament of increasing demand, rising costs and diminishing resources, we must rely on nuclear energy or coal (the two least ecological forms of energy), renewable sources such as solar energy and hydroelectricity, and on energy conservation and efficiency. The latter, sometimes called the fifth fuel, is more sustainable than non-renewable sources because it produces more services with limited resources.

Use of fossil energy for transportation is presently the major cause of GLOBAL WARMING, according to experts of the International Panel on Climate Change, who propose a 'no regrets strategy' for curtailing the use of fossil fuels. Due to its large size and cold climate, Canada requires much energy, but Canadians waste more energy per capita than northern Europeans and nearly as much as US citizens, who are the most wasteful consumers in the world.

See also:

price elasticity

JEAN-GUY VAILLANCOURT

Engel's Law

Engel's Law states that households spend an increasing amount, but a decreasing proportion, of disposable income on food as their incomes rise. In the nineteenth century Ernst Engel discovered this relation, noticing that as incomes of families rose, the part of their budget spent on food declined. Very poor households devote more than half of their incomes to food and have relatively high INCOME ELASTICITIES OF DEMAND for food:

that is, a significant proportion of any additional income will be used to buy food. At higher income levels, the share of income devoted to food purchases falls to one-quarter or less, and the income elasticity of demand for food becomes quite low. Recent studies found partly contrary evidence to Engel's Law, since increased income also results in increased spending on better quality food, which is generally more expensive.

The consequence of Engel's Law at a national level is that when development takes place, the demand for agricultural output will not grow as rapidly as the demand for industrial products and services. Hence, the share of agriculture in national product declines over time.

N.M. DUYKERS

enterprise culture

'Enterprise culture' was the concept used, especially during the late 1980s, to denote the Thatcher government's attempts to restore a society in which individual entrepreneurial initiative, or enterprise, could once more flourish as the principal agent of social change in the United Kingdom. The underlying thesis was that the UK's leadership of the world during the INDUSTRIAL REVOLUTION and its construction of a vast empire had been built by the enterprise of heroic entrepreneurs.

The capacity of entrepreneurs in the United Kingdom to innovate and take risks in the freedom offered by open markets and a minimum of state intervention had been undermined after 1945 by the creation of a dependency culture, the antithesis of the earlier enterprise culture. Individuals and companies had become increasingly dependent on the state's inefficient and bureaucratic interventions, rather than their own private initiative, for their prosperity.

Previous state-led modernization programmes undertaken by both Labour and Conservative governments were held to have bequeathed a poisonous ideological, policy and institutional legacy which required disman-

ling. Sir Keith Joseph therefore used his inaugural speech as a minister in the first Thatcher government to identify the existence of an anti-enterprise culture in the United Kingdom as being one of six main obstacles to full employment and prosperity, along with high state spending, high direct taxation, egalitarianism, nationalization and a Luddite trade union movement.

Despite eleven years in office, and the windfall political and economic dividend of more than £200 billion of North Sea oil revenues and privatization receipts, the Thatcher government's attempts to restore an enterprise culture in the UK failed to reverse the country's relative economic decline. The macro-economic environment of low inflation, low taxation, and a strong and stable exchange rate – held to be the economic prerequisites for a restoration of entrepreneurship and enterprise in the UK – was never achieved on a sustained or sustainable basis. Financial DEREGULATION, PRIVATIZATION and an open market for corporate take-overs guaranteed that the quickest and easiest profits tended to arise from the amalgamation and restructuring of existing businesses, rather than from investment in the development of innovative new businesses where the degree of risk and uncertainty was much greater, but more in keeping with a genuinely entrepreneur-driven enterprise culture.

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SIMON LEE

environment

The environment has long been seen as an external input to, or constraint on, human

actions at different spatial scales, including the international scale. The environment is often equated with the natural world. Analysis of the environment then tends to be deterministic or instrumental. More recently, attention has been directed to the fragility of some human-disturbed environments and to the need for environmental protection to secure sustainable economic development. The environment has also been understood as a resource for human societies, or as a social or political construction.

In the first half of the twentieth century, static and determining views of the external world, or environment, dominated accounts of GEOPOLITICS. The British geopolitician Sir HALFORD J. MACKINDER maintained that if humans initiate (here in the domain of statecraft), nature in large measure controls. Spykman was blunter still:

Geography is the most fundamental factor in the foreign policy of states because it is the most permanent. Ministers come and go, even dictators die, but mountain ranges stand unperturbed.

(Spykman, 1942: 41)

The environment here consists of fixed physical features which are external to human societies. Mountain ranges, rivers, coastal zones, deserts and climatic systems define an environment 'out there' and provide a restrictive template for human actions. This view of the environment continues to inform geopolitics. Practitioners of statecraft refer to strategic 'zones of conflict' or 'shatter belts', where the zones and belts are defined by fixed environmental features or geographical juxtapositions.

Deterministic accounts of human-environment relationships are less popular than they once were. Their legacy is most apparent in studies of conflicts around finite resources. Supplies of oil or coal or iron ore are said to be running out and human societies are asked to adjust accordingly. An appropriate response might be population control; an inappropriate response might be capturing resources by means of warfare or neo-imperialism. Some versions of ENVIRONMENTALISM take shape

within this broad intellectual framework. Most calls for SUSTAINABLE DEVELOPMENT accept that the environment imposes limits to economic growth. It is the responsibility of politicians to strike a balance between short-term and long-term economic goals.

Not all accounts of environmental politics accept the neo-Malthusian tones that inform resource pessimism (see NEO-MALTHUSIANISM). Students of political ecology maintain that environmental problems like deforestation or soil erosion are the products of unequal patterns of access to capital, labour and property (including common property resources). Class, gender or ethnic relationships are constitutive of particular local environments (for example, through land-tenure arrangements) and environmental maladies result mainly from unequal power configurations. In this fashion, environmental problems are constructed as social and political problems, and not as the unmediated effects of rapid economic or population growth. The same logic can be extended to the international scale. More socialized accounts of the environment also help us to denaturalize our accounts of the external world. Rice terraces in Nepal and megacities in the United States are environments every bit as much as the ostensibly virginal forests beloved by ecopopulists and resource pessimists.

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S.E. CORBRIDGE

environmental economics

Environmental economics is the economics of natural resource use and preservation, using economic principles to advise about the prevention, compensation and mitigation of external effects on national, regional and global economies. External effects or EXTERNALITIES are generally defined as the effects on the output levels of firms and the utility levels of households which result *directly* from the activities of other firms and households – that is, without having been mediated by market pricing-mechanisms. More specifically, externalities cover all forms of pollution, overexploitation of natural resources, destruction and reduction of biodiversity, and induced climate change. Despite the many environmentalists who believe that economics is not the solution but is the problem, environmental problems appear to be mostly economic in nature and for that reason require economically sound solutions. In that sense, the BOLSHEVIK revolution may well have been one of the worst environmental disasters of this century.

Within the framework of economics, it is generally agreed that one of the consequences of failing to correct a pollution externality is a (static) misallocation of resources among firms and industries. Two maxims derived directly from (neo-classical) micro-economics (see NEO-CLASSICAL ECONOMICS) have been suggested as general guidelines for correcting pollution externalities. The first is that any particular level of pollution abatement should be obtained with the least costly combination of available means by applying the equimarginal principle of resource allocation. In particular, it is argued that a percentage reduction in waste emissions applied equally to all firms and

industries would be inefficient because of their different costs of abatement at the margin. The second abstract guideline is that the optimum level of pollution abatement is that level at which the cost of further emission controls would exceed the value of additional gains in environmental quality. This maxim has been invoked to point out that pollution abatement entails the use of scarce resources, which might otherwise be devoted to producing more conventional 'goods' and consequently that we should never aim to get rid of absolutely all external effects of one activity on another, since the net gain from doing so would be negative. Rather, minimization of total pollution costs involves choosing a correct balance between expenditure on preventing pollution, expenditure on avoiding the damage caused by pollution, and continuing to suffer the damage to welfare caused by pollution. It has been argued that private market economies have faced severe pollution diseconomies because of an inadequately comprehensive system of PROPERTY RIGHTS. Although the general legal principle that the atmosphere, lakes, rivers and coastal waters are common property assets is well established in many capitalist societies, enforcement of the public right to ration private (and public) use of these common properties is less well established. The existence of private property rights to most real assets ensures that the relative scarcity of these assets will be taken into account by their private users, even though these users may be motivated solely by private material gain. However, the failure to ration the use of 'common property resources of great and increasing value' means that they will be overused relative to both private and public property that is subject to charges for its use or to rules about its use. A variety of procedural means for correcting pollution externalities in market economies have been identified. One line of argument is that pollution control could conceivably occur without public intervention as a result of voluntary contractual agreements between polluters and those adversely affected by waste emissions. If the costs of identifying polluters and fellow victims, of forming

coalitions of aggrieved parties, and of bargaining over the distribution of abatement costs were negligible, one would expect to see those who bear pollution externalities offering to pay polluters to reduce their effluent discharges.

In Figure 2, for example, there is an incentive to move from output OM to OQ with change of prices P to P' reflecting changes in marginal costs (MC), since by doing so there will be a gain equal to the area of triangle ebd to be shared by the beneficiaries of product X and the externality victims. The maximum sum the externality victims would be willing to pay to reduce the market output by MQ is equal to the area of the parallelogram $abcd$, while the loss to producers and consumers from reducing the output is equal to the area of the triangle abd . The line $D-D$ is the demand line for the good in question.

In practice, however, one does not often observe the consummation of such private contracts within the current framework of statutory and common law. Their absence is *prima facie* evidence of substantial transaction costs which deter individual victims from bargaining directly with polluters in order to realize some sort of relief. Thus, even though individual victims may suffer welfare losses because of a nearby pollution source, they will probably tolerate the emissions because alone they cannot afford to buy pollution abatement from the polluter and because organizing a coalition to finance the compensation would be personally expensive. It is fairly clear, then, that

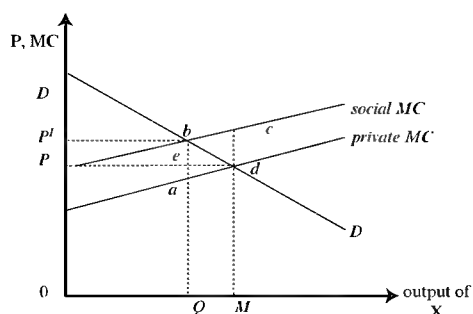


Figure 2 Determination of optimal output in presence of externality

the existing system of private property rights and legal remedies has been inadequate and that public action of some sort is required in order to 'internalize the externalities' of pollution. Perhaps the least radical departure from existing legal and economic institutions is Mishan's suggestion that the state creates private 'amenity rights' – that is, private property rights to privacy, to quiet, to clean air and water (Mishan, 1967). After appropriate modifications of the law of torts and trespass, individuals could demand financial compensation for the infringement of their 'amenity rights'. The prospect of having to pay compensation would presumably induce polluters to reduce the magnitude and virulence of their external effects.

Probably the most frequent line of argument has been that the imposition of an 'effluent tax' – that is, an excise tax on waste emissions – would suffice to correct pollution externalities and thereby eliminate the problem of environmental pollution. Assuming that Firm A is a perfect competitor in a perfect market (except for the pollution externality), the traditional remedy is to tax the output of Firm A, so that the tax corresponds to the marginal value E at the level of output which is optimal after the imposition of the tax. In other words, after the levying of the output tax to correct the pollution externality, it must be true that $MC + P - t + P - E$, where P is the competitive product price which Firm A faces, t is the excise tax rate per unit of output, and MC are the marginal costs of output other than the tax.

GENERAL EQUILIBRIUM models of environmental pollution have more commonly been developed within an input-output or a materials-balance context, rather than a market exchange framework. We have witnessed modifications which permit the incorporation of waste residuals into input-output models of the economy. In principle, the primary application of an input-output model of environmental pollution is in making short-term projections of waste loads, given sectoral technologies, the INCOME ELASTICITY OF DEMAND for various commodities and the anticipated growth of national income. Given these

potential waste loads, one can then project the magnitude of abatement activity necessary to maintain environmental quality at a particular level. Only more recently have economists begun to characterize environmental pollution as a dynamic problem intimately related to economic growth, as well as a problem of static resource misallocation. In the absence of pollution abatement efforts, one would actually expect pollution to grow more rapidly than per capita consumption once the limited capacity of the environment to absorb wastes has been exhausted. Unless the income elasticities of demand for final products are such that the sectoral composition of aggregate output continues to shift towards activities with relatively low effluent propensities, pollution will grow at least as fast as aggregate output. If one assumes a constant average propensity to consume, it will also grow at least as fast as total consumption, which exceeds the growth rate of per capita consumption as long as the population is growing.

There is a somewhat distinct school of thought on the economics of environmental quality which, in addition to formulating pollution as a dynamic problem, reaches the theoretical conclusion that a global 'stationary state' economy will eventually be a social and biological necessity. This view's basic premise is that neither raw material supplies nor the waste-assimilating capacity of the natural environment is infinite in scope and consequently that we cannot expand indefinitely the flows of natural resource exploitation and environmental waste disposal. The apparent implication of this proposition is that the rate of growth and the level of national income are becoming increasingly unreliable, or even perverse, social welfare indicators. This also suggests that we broaden our concept of capital to include natural biological and physical systems. To keep flows of waste discharges below the limits set by ecological thresholds we should be concerned about the durability of the stocks. 'Durability' means more than just how long a particular commodity lasts. It also includes the efficiency with which the after-

use 'corpses' of a commodity can be recycled, leading to SUSTAINABLE DEVELOPMENT.

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HANS W. GÖTTINGER

environmental impact of projects

Development projects have become increasingly a matter of concern because of the pervasive nature of the resulting environmental damage. Impacts can include increased POVERTY, dislocation of people, and loss of species and ecosystem functions. Thus environmental impacts can have intergenerational implications. Contrary to the technological optimism of the 1950s, development projects are no longer seen as good *per se*. This has required international agencies, such as the WORLD BANK, to reconsider how they assess projects for loans. Similarly, environmental assessment is now legislated in many countries.

A key issue that has arisen through this recent awareness of the potential importance of environmental impacts is exactly how they should be assessed. Environmental Impact Assessment (EIA) concentrates on the physical as opposed to economic or social impacts, listing them by type and range. EIAs are often complex (especially for large-scale projects with numerous environmental interactions) and, for example, require knowledge of ecosystems' functions and food webs. Decisions are required on the spatial and temporal scale of the analysis and systems boundaries. Legislation can achieve some uniformity, but the complexity of actual systems remains. EIAs are primarily based within environmental science.

Environmental cost benefit analysis (CBA) is also employed to assess financial and economic impacts of projects. This has resulted in controversy over reducing diverse environmental and social values, which are often incommensurable, to a single measure. Critics of this type of reductionism in mainstream economics, such as some ecological economists, recommend multicriteria decision analysis and participatory decision processes. Thus, the assessment of the environmental impacts of projects has become an area of debate over methods and methodology.

See also:

ecological economics; environment; environmentalism

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CLIVE L. SPASH

environmental security

'Environmental security' is a term used by scholars and practitioners to posit linkages between environmental conditions and security interests. Although competing notions of environmental security abound, they generally fall into three sets of claims: (1) states and non-state actors should guard against environmental degradation for the same reason they guard against organized violence – both kinds of threats can harm human, material and natural resources on a large and disruptive scale; (2) local and regional environmental degradation and/or resource scarcities (exacerbated by POPULATION GROWTH, inequitable wealth distribution and global environmental changes) are an important contributing factor to subnational political instability and violent conflict; (3) military and security institutions (including intelligence agencies) can and should play a greater role in environmental protection. The

rise in popularity of environmental security slogans has accompanied the increasingly prominent calls for new definitions of security to replace COLD WAR concepts predominantly rooted in REALISM.

Many scholars and practitioners question the operational utility and analytical appropriateness of linking environmental issues with security, raising arguments along the following lines: (1) threats to well-being are fundamentally different from military threats; (2) overly broad definitions of security render the term useless; (3) environmental security is merely another tactic used by developed countries to impose their values on developing countries and infringe on the latter's sovereignty; (4) there is a fundamental mismatch between the means required for sustainable development – marked by transparency, cooperation and public participation – and the conflictual orientation of security institutions; (5) environmental security rhetoric encourages thinking that could lead nations to undertake military intervention in the name of protecting 'global' resources; (6) the empirical findings that environmental scarcities contribute to violent conflicts are questionable, as environmental factors are at best tangentially related to conflict and, in any case, are overshadowed by more important socio-political and economic variables.

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P.J. SIMMONS

environmentalism

'Environmentalism' has two distinct meanings in social science:

- 1 the epistemological assumption that an individual's surroundings, both natural and

social, are influential in terms of DEVELOPMENT, beliefs and actions; at the extreme, this fades into material DETERMINISM;

- 2 the systems of IDEOLOGY, belief and practice that place a priority on the conservation, preservation and restoration of the natural ENVIRONMENT, including its biological (plants, animals), physical (atmosphere, oceans, land, water) and socially managed (hedgerows, beaches) components.

Within the second definition, there can be found a number of important variations that reflect both historical practices and contemporary political and social conflict. 'Wise use' environmentalism is associated with policies of resource-conservation and the Conservationist Movement of the early 1900s. Its followers are generally regarded as politically conservative, seeking to maximize accumulation from resource extraction, while relying on PRIVATIZATION, market mechanisms and minimal public intervention to limit damage. 'Liberal' environmentalists seek to maximize the efficiency of resource-use through reliance on market mechanisms, but also recognize that control of some EXTERNALITIES and MARKET FAILURES (such as climate change and air or water pollution) may require regulatory intervention by governments. 'Preservationists' support the protection of sensitive and critical areas through the creation of parks, reserves and restricted wilderness areas. 'Restorationists' seek to intervene actively in threatened or damaged ecosystems and return them to a condition assumed to exist prior to human intervention (although it is widely held that no such environments exist in today's world).

There are also more radical forms of environmentalist belief and practice, described as 'social', 'socialist' and 'deep' ecology. Social and socialist ecologists regard the oppression of nature and human beings by man and CAPITALISM as being of a piece (while many feminist ecologists replace the term 'human beings' with 'women' – see FEMINISM). Ecological preservation therefore requires major structural changes in society. Deep ecologists are concerned primarily with the inviolability

of nature and wilderness, the stabilization or reduction of human populations and some degree of DEINDUSTRIALIZATION.

Generally speaking, environmentalist ideologies minimize or ignore the structural role of POLITICAL ECONOMY and CULTURE in the environmental degradation they so deplore. This results in policies and practices that address the visible symptoms of damage while leaving deeper causes intact. Dealing with these deeper causes would, undoubtedly, require major social, political and economic changes to 'business as usual'. For quite understandable reasons, such changes do not frequently appear on the agendas of governments or established political parties.

See also:

alternative development; appropriate technology; demographic trends; ecodevelopment; ecological economics; holism; hydropolitics; Malthus, Thomas Robert: population growth; raw materials; Schumacher, E.F.; social limits to growth; sustainability

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RONNIE D. LIPSCHUTZ

epistemic communities

The concept of 'epistemic communities' was invoked by constructivist scholars of international relations (IR) to focus analytic attention on the process by which states formulate interests and reconcile differences of interest.

Epistemic communities are a principal channel through which consensual knowledge is applied to international policy coordination, and by which states may learn through processes of international COOPERATION.

John Ruggie introduced the term 'episteme', borrowed from Foucault, to describe the overarching perspective through which political relationships are visualized and understood during historical eras (Ruggie, 1998). The winter 1992 issue of *International Organization* on 'Knowledge, power and international policy coordination' focused on the actors responsible for articulating and aggregating knowledge-based understanding in areas of security, environment and international political economy (IPE) (Haas, 1992).

Epistemic communities are networks of knowledge-based communities with an authoritative claim to policy-relevant knowledge within their domain of expertise. Their members share knowledge about the causation of social or physical phenomena, in an area for which they have a reputation for competence and a common set of normative beliefs about what actions will benefit human welfare in such a domain. In particular, they are a group of professionals, often from a number of different disciplines, who share the following set of characteristics:

- 1 Shared consummatory values or principled beliefs: such beliefs provide a value-based rationale for social action of the members of the community.
- 2 Shared causal beliefs or professional judgement: such beliefs provide analytic reasons and explanations of behaviour, offering causal explanations for the multiple linkages between possible policy actions and desired outcomes.
- 3 Common notions of validity: intersubjective, internally defined criteria for validating knowledge.
- 4 A common policy enterprise: a set of practices associated with a central set of problems which have to be tackled, presumably out of a conviction that human welfare will be enhanced as a consequence.

If contemporary IR is characterized as a setting of complexity and uncertainty (as argued by constructivist scholars), particularly under contemporary circumstances of complex interdependence (see *INTERDEPENDENCE, COMPLEX*), increasing *GLOBALIZATION* and the appearance on the international agenda of new technical issues with which traditional decision-makers are habitually unfamiliar, then state interests are often unknown or incompletely specified. IR then becomes a matter of applying embedded and institutionalized beliefs about the nature of problems and the appropriate means of collective response, rather than the process of resolving rationally formulated state preferences, as argued by many current theorists of IR (Adler, 1997; Haas, 1990, 1992; Ruggie, 1998). Changes in information processing are likely to follow well-publicized shocks or crises. Only at such times are decision-makers likely to recognize major anomalies and pursue new policy patterns. During subsequent, less revolutionary periods, these new doctrines or orthodoxies assume the status of taken-for-granted assumptions or dogma, which persist until called into question again by external stimuli. Because of the disjointed equilibrium nature of policy change, an evolutionary focus on institutional learning and path dependence may provide an appropriate model by which to understand the international recognition and response to global change. Such a research programme may provide better understanding of factors which influence the introduction of new policy frames, collective understandings or doctrines, as well illuminating mechanisms of lock-in and identifying those factors which may influence the degree of irreversibility of national and collective actions.

Epistemic communities are one of the principal actors responsible for aggregating and articulating knowledge in terms of state interests for decision-makers, and for disseminating those beliefs internationally. In a broader political context, epistemic communities provide one of the major channels by which overarching regime principles, norms and rules are articulated for the international

community, and disseminated internationally. While epistemic communities are the principal agents responsible for articulating such principles, norms and rules, the extent to which they become more deeply diffused and embedded internationally has to do with the political influence of epistemic community members; their ability to persuade others, their ability to consolidate bureaucratic influence in important institutional venues and their ability to retain influence over time. State interests and decisions to deploy state power are thus identified subject to consensual knowledge.

Epistemic communities are likely to be found in substantive issues, where scientific disciplines have been applied to policy-oriented work and in countries with well-established institutional capacities for administration and for science and technology. Only governments with such capacities are likely to see the need for the technical skills which epistemic community members command, and such professionals would only be attracted to governmental service when they believe that their policy enterprise can be advanced. Crises or widely publicized shocks are probably necessary precipitants of environmental regime creation, but crises alone are insufficient to be able to explain how or which collective responses to a perceived joint problem are likely to develop. Epistemic communities, then, help identify cause-and-effect relationships, elucidate interlinkages between problems, help define the consulting states' or organizations' interests, and help to formulate policy. Their aggregate effect depends on the extent to which their ideas become embedded in influential multilateral institutions more generally: powerful countries and international institutions, and possibly *NON-GOVERNMENTAL ORGANIZATIONS* (NGOs), who will then deploy their own influence to disseminate the shared ideas enunciated within the epistemic community. Overall, learning will occur in the policy system as new policy-relevant knowledge is identified and applied to a common problem.

Empirical work has found that in environmental issues, many of these experts have been members of an ecological epistemic community

(Haas, 1990). Members of the epistemic community that has dominated technical discussions in environmental regimes have subscribed to holistic ecological beliefs about the need for policy coordination subject to ecosystemic laws. Thus they promote international environmental regimes which are grounded on policies which offer coherent plans for the management of entire ecosystems, sensitive to interactions between environmental media (such as air and water), sources of pollution and contending uses of the common property resource, rather than being limited to more traditional policies for managing discrete activities or physical resource spaces within fairly short-term time horizons.

In IPE, similar dynamics are associated with the popularization and dissemination of major economic doctrines, including the WASHINGTON CONSENSUS (Williamson and Haggard, 1994), Keynesianism (Hall, 1989 – see KEYNESIAN ECONOMICS) and STRUCTURALISM and DEVELOPMENT ECONOMICS (Adler, 1987; Biersteker, 1992).

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PETER M. HAAS

equality

Importance

In times of POST-MODERNISM, equality is an unfashionable value. The rejection of grand narratives (in particular HISTORICAL MATERIALISM), the rise of post-industrial society and REFLEXIVE MODERNIZATION, the breakdown of COMMUNISM, the problems of the WELFARE STATE, PRIVATIZATION in mixed economies, the assaults of 'REAGANOMICS', Thatcherism and a neo-liberal individualist deregulation philosophy and praxis seem to put egalitarian considerations in the backyard.

However, it is not only in the advanced countries of the West that full employment, social security and rising living standards have ceased to be the actual social experience of everybody. Rather, double-digit unemployment rates in Europe, the effects of GLOBALIZATION and CAPITAL MOBILITY (for example, the limited possibilities of individual states to effect some redistribution through taxing and fiscal policy), the decline of unionization in the aftermath of industrial capitalism which undermines countervailing power and real wages, occur. Furthermore, the pending problems of intergenerational distribution, the persistent racial and gendered (not only) economic inequalities and discussion of adequate policies (for example, affirmative action), the increasing skilled/unskilled wage gap due to technological change and the internationalization of economies and labour markets, the dramatic increase of the ratio of executive to other employee compensations, the winner-take-all phenomenon, the regime costs (police) inequality, and

(for example) the ecological impossibility of an internationalization of Western consumption patterns, demonstrate that social JUSTICE and equality are important dimensions and deserve a more detailed analysis.

Frames

No intrinsic or inherent meaning of equality exists. But two IDEAL TYPE opposite basic views can be discerned, which underlie in different degrees any deliberation on equality. One is a more negative or restricted view on equality, expressed (for example) in LIBERALISM as an achievement concept of equality. Freedom of the autonomous and independent individual is the main value, EGALITARIANISM and redistributive policies should be reduced to a minimum (such as equal access to basic education). Some liberal thinkers, like FRIEDRICH VON HAYEK, argue that the notion 'equality' has no real meaning and that the pursuit of an egalitarian policy leads down the road towards serfdom. Robert Nozick (1974) holds that even drastic differences in income and wealth should be accepted. The best coordination mechanisms of action plans are anonymous markets as optimal institutions for promoting human WELFARE. Egalitarian policies and structures are criticized because they restrain excellence and proficiency, and lead to a loss of economic productivity and cultural diversity.

By contrast, the positive view has a need-oriented, egalitarian stance. Redistribution plays an important role, equality of chance and condition are seen as desirable states of a good society. Differences in wealth, income and social status do not emerge primarily due to achievement and effort. They are seen as the result of different hereditary dispositions, pure luck, privileged education, inherited wealth and unfair rules of the game like distorted competition. The extreme end-state ideal of this orientation – for example, in most utopias, early SOCIALISM, the early COMMUNISM (of Maréchal and Babeuf) and some religious sects – is a completely equal income and wealth distribution.

In the real world, compromises prevail. The German social market economy is an example. In most Western countries the most abstract values are freedom, well-being, justice, peace, security and equality. Because of natural tensions between them, a choice has to be made – dependent on philosophy, interests and the prevailing social-economic system – as to which value should have precedence.

Dimensions

The notion of equality is multifaceted and, in the case of 'all men are born equal', almost meaningless until specified, because we can ask: equality of what and between whom? The Dred Scott case (1856/7) may serve as an example: the US Constitution granted legal equality to all citizens of the States but, by excluding slaves from citizenship, denied them equality because they had no 'judicial personality' (an inequality that was not reversed until the passage of the Fourteenth Amendment).

Equality can refer to properties that people are considered to hold in common or to treatment that people receive or ought to receive. To assume equality of characteristics means to decide that some resemblances are more significant than differences that are natural (colour, character, GENDER, other natural endowments) or institutional (religion, social position, citizenship). There also exist differences in degree of common properties (age, strength, possessions, power, intelligence). Resemblances can refer to, for example, human nature, basic motives (self-interest), the capacity to feel pleasure and pain, the feeling of empathy, the common use of language, the belonging to a political, social, cultural or religious community, or common BASIC NEEDS.

Equality of treatment can refer to legal rights (to vote, to own property), legal duties (such as respecting the rights of others), material benefits (social services, wages, unemployment benefits), material liabilities (for example, taxation, military service) and opportunities (such as the opportunity to hold certain offices or positions). Equality of treatment can be absolute (the right to vote) or

relative (unemployment benefits depending on former income). Inclusive sameness often implies the establishment of differences: children and non-members (for example, guest workers) have no right to vote.

In principle, three levels of social relationship can be distinguished in relation to equality. The first domain comprises legal rights (namely equality in relation to effective laws); however, legal equality in, for example, constitutional rights is compatible with profound inequality as far as political participation and social equality of chances and positions are concerned. The second domain is political equality (participation in the political decision and deliberation process), which is compatible with social inequalities. The third domain is relative or absolute social equality, which does not necessarily imply legal and political equality, but has historically been understood (for example, by KARL MARX) as the necessary material complement to formal – that is, legal and political – equality. In addition, three sometimes conflicting dimensions of interpersonal equality can be discerned: material well-being, agency (the individual power to act) and freedom to act (absence of exterior restraints). Equality in the sense of freedom to act is most consonant with equality of opportunity (to compete on equal terms, for example, through equal pay, regardless of race, gender and so on), equality of well-being with economic equality (for example, the satisfaction of basic needs) and equality of agency can be exemplified by affirmative action.

Equality concepts can also be distinguished according to different degrees. The most pronounced is the criterion of impartiality – that is, the impartial application of the law. Equal shares to all is a less restrictive concept. Equal shares to equals (for example, the same income tax for persons in the same income bracket) is less restrictive and would not be egalitarian according to the principle of equal shares to all. A further narrowing down is proportional equality – that is, the unequal shares to unequals, but in proportion to their inequality. An even less restrictive concept is unequal shares in respect to relevant differ-

ences – for example, no voting rights depending on gender, race or wealth. The most restrictive concept of equality is the Aristotelian notion of giving to each according to their desert – that is, what is deserved is the only relevant characteristic to allocations. The different concepts all depend on valuational principles, but can also be evaluated according to their empirical inclusiveness (for example, voting systems that include women are more egalitarian than systems that disenfranchise them).

Despite these differing concepts and often conflicting dimensions, there has been a consensual starting-point in Western thought since the enlightenment which unites the legal, political and economic sphere: a democracy with the principles of tolerance and justice is incompatible with strong economic inequalities.

History

In a broad historical perspective, inequality is a recent phenomenon. Besides pastoralism and horticulture, two basic socioeconomic systems – hunter-gatherer and agricultural systems – can be distinguished in human history. Hunter-gatherer societies prevailed until 10,000 years ago. Their characteristics were small groups, fluent and unstable organization (fission and fusion), high mobility (nomadism), extraction of natural resources (food collectors), no authoritarian leadership (first among equals), low degree of specialization and division of labour (women were the more important gatherers), egalitarianism (no social stratification), flexible concepts of kinship, camp-fire democracy, no property or ownership of resources, lack of territorial claims, disputes (but no wars) and some sort of polytheistic religion. Hunter-gatherers lived a relatively short and simple life – but it was egalitarian.

With the plough and agriculture, arose the multifaceted problems of inequality, because of fundamental changes in economy and society: investments in the environment and private property, the control of resources, intensive cultivation, permanent local groups, a higher population density, states as the norm, devel-

oped political systems with a central power, social stratification and division of labour, taxation (of goods, money and work, including military conscription), fully developed concepts of TERRITORIALITY, the existence of war, priests (full-time religious specialists), a religious tendency towards exclusive monotheism. The price of civilization and development was the loss of the face-to-face integration of early egalitarian-democratic groups. Inequalities with respect to income, gender, citizenship, kinship, race and so on, could and did emerge, at least with the advent of the early state, namely in Ancient Greece and medieval Europe.

Politics

With these historical changes, political and philosophical attempts to abolish, legitimize or reduce (in)equality were worked out. Greek political philosophy, at least that of Plato (427–347 BC) and Aristotle (384–322 BC), divided men into civilized and barbarians once humanity had left the egalitarian Golden Ages. All non-Athenians were of such inferior status that they were excluded from citizenship and other legal rights. Humans were considered by their nature unequal, so women and slaves were excluded from political participation. On the other hand, the Greeks established rational reflection on inequality in philosophy and literature, and developed the first direct democracy in history (albeit only for the male citizens). But already the Sophists urged generalization and an equal rights status. The Roman Stoic cosmopolitan philosophers like Seneca (2 BC – AD 65) broke through the barriers of state, race and creed, and held that equality is a natural right, deserved by all rational humans, who should therefore be able to participate in government. But other Stoics limited these principles to private ethics.

(Early) Christian thought was based on the spiritual equality of all men, but this was counterbalanced by the doctrines of original sin and the working of divine providence, which implied – not only in a scholastic perspective – inequality and could justify

slavery, as well as hierarchical FEUDALISM. Furthermore, the duality between secular and religious could be interpreted as indicating the irrelevance of legal, political and economic equality to the inner world. On the other hand, Jesus' original message was Christian personalism, including political and economic solidarity and brotherhood. Individual rights and political equality were claimed during the Reformation – for example, in the Peasant's War in Germany (1524–6) – but gained no support from the secular conservative Luther.

In the modern period, Western thought puts the emphasis on the individual and the rights of the individual – rights that were first formulated against the feudal lords in the cities after the twelfth century. Equality was also created by inequality, in that the absolutist sovereigns levelled all positional status differences below themselves. Equality by nature is an integral part of Thomas Hobbes' (1588–1679) contractual model, based on self-interest (everybody is able to kill their neighbour, so a strong sovereign is needed), or in John Locke's egalitarian view that each person starts as a blank tablet, without innate ideas, differential capabilities and so on. For Locke, policy has to guarantee the life, liberty and property of everybody. When Alexis de Tocqueville (1805–59) states that, in the United States, 'equality is the distinguishing characteristic of the age they live in', it has to be kept in mind that the early liberal thinkers concentrated on the legal-political dimension as the focus for the emancipation of the middle classes from feudalistic bonds in Europe, and as an expression of US exceptionalism (the open frontier) and an argument for independence from the British Commonwealth. In recent discussions, J. Rawls gives the contractual approach a particular egalitarian switch, arguing that all people need some basic goods (including liberties, chances, capabilities, competencies and responsibilities) and accepts an unequal distribution of income because the advantages of the worse-off should be maximized in that situation.

In Western thought a basic tension exists between individualism – the principle of

freedom to act, distinguishing excellence – and Bentham's (1748–1832) utilitarian equal right to achieve pleasure, satisfaction and happiness, alongside the conviction that (resulting) social inequalities and hierarchies are inadequate and lead to corrupt institutions that should be abolished. This was pointed out by Rousseau (1712–78) who argued that humans are by nature rational and good but have been corrupted by artificial institutions, like private property, which destroy the natural sentiments of man and constitute artificial inequality. The implication is that – if people are equal by nature – privilege, authority and differences in wealth are not legitimate. For Rousseau, an orientation for the common good and a more or less political-economic equality were prerequisites for a functioning democracy.

KANT's (1724–1804) principle of the categorical imperative – treating other people always as ends, and never as means alone – constituted respect for the equality of humanity in the moral dimension, while Hegel's (1770–1831) focus, in his idealistic and dialectical concept of history, on the duty of people to identify with the purpose of their stage and state, offered a non-egalitarian stance. Since the mid-1860s, social Darwinism and cultural criticism of the upsurge of the masses (Ortega y Gasset) were, in the Nietzschean tradition, a stronghold against egalitarianism. Marx (1818–83) and the social(ist) movements of his time criticized contractual and idealist concepts, and demanded social and economic equality as a reaction to the lamentable working and living conditions of the emerging proletariat under industrial capitalism. They demanded the full realization of the demands of the French Revolution (1789): 'Equality, liberty and brotherhood!'. The communists and many socialists saw in the abolition of private property, the socialization of the means of production and the abolition of classes, the final solution for the problem of inequality.

Economy

In economic theory, NEO-CLASSICAL ECONOMICS and GENERAL EQUILIBRIUM theory dom-

inate; they are much more concerned about allocation and efficiency, than about distribution and problems of equality. Heterodox minority approaches like the German Historical School (Schmoller), 'old' INSTITUTIONALISM (Commons, GALTUNG, GALBRAITH) and POST-KEYNESIAN ECONOMICS put a major emphasis on 'equality'. These differences in perspective depend on their opposing research strategies, final assumptions and principles (the first expression in each of the following pairs reflects orthodoxy, the second expression reflects heterodox approaches): methodological individualism versus holism (see HOLISM: INDIVIDUALISM, METHODOLOGICAL), maximizing individual RATIONAL CHOICE versus socially defined rule-following, spontaneous evolution versus conscious political design, the efficiency of markets versus necessary social reform (like the New Deal).

Orthodoxy only requires information on ordinal preferences, without any interpersonal comparability. From this it can be concluded that interpersonal comparisons are impossible and meaningless. The unfettered market mechanism is indifferent to distributional criteria, as well as the normative 'Pareto' criterion: if men and women receive equal pay for equal work, and the wage for men is doubled, we have a Pareto improvement – some people are better off, no one is worse off. But injustice and inequality has increased. A 50 per cent increase for both would be fairer, but the Pareto norm cannot distinguish them.

For heterodoxy, the breakdown of authoritarian state ownership and political dictatorship in favour of democratic market systems is not equivalent to saying that egalitarian improvements are now impossible. Some points of focus for the debate are:

- 1 Is there a necessary trade-off between efficiency and equality? Examples are the egalitarian and growth-oriented developments of the Asian countries. One argument is that in poor countries redistribution of land and, simply, calories can raise output and welfare. Another argument is that workers are often costly to supervise, so it

would be more efficient if they owned their equipment and were self-employed. Furthermore, if poorer people have some resources that enable them to borrow for investments, lenders would expect this partial self-finance to reduce moral hazard.

- 2 What are the relevant basic primary social goods – nutrition, literacy and health? How can they be measured and achieved (by using SELF-HELP concepts, perhaps)? The yearly report of the United Nations Development Programme basically uses three criteria (drawn from SEN's work) to show that according to this composite index, about one third of the world's countries are – in absolute terms and per capita – worse off when compared to the 1970s.
- 3 How can PROPERTY RIGHTS be changed to increase efficiency, democracy and equality? Who should own firms and who should earn profits? The conceptions of share and STAKEHOLDER ECONOMIES, an elucidated MARKET SOCIALISM, a popular shareholder capitalism (giving young people non-transferable coupons in stock), alternative forms of public and worker ownership, new taxation principles (for example, inheritance and wealth taxes) and so on are all discussed.

Future

A (post-)modern concept of 'complex equality' was developed by M. Walzer (see Miller and Walzer, 1995). An egalitarian society is one which recognizes a number of distinct spheres or goods, between which exchanges are blocked – for example, those between money, power, office, education and so on. Equality of status results when equal citizenship is combined with plurality in the distribution of social goods, so that money cannot buy office, education or power. Some people will be successful at making money, others achieve recognition as artists, still others come to prominence in politics, and so on. For Walzer the (present) danger in market societies is that money overrides all other spheres, endangering social diversity and constituting a one-pillar ranking system.

Taking into consideration global disparities of wealth and life prospects, and the ecological LIMITS TO GROWTH, ecologist H. Daly opts for a global arrangement to fix absolute limits of material throughput. This is in order to stop population growth and drastically reduce income and wealth disparities (setting a maximum ratio of 1:10), because these disparities and inequalities induce wasteful consumption, inefficient competition, the striving for POSITIONAL GOODS and emulation in general (as argued by THORSTEIN VEBLEN), aspirations that may overstrain the capacities of our planet.

See also:

distribution of income; ecological economics; neo-classical economics, critique of; quality of life

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equalization of returns to factors of production

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HELGE PEUKERT

equalization of returns to factors of production

The conventional model of international trade (see HECKSCHER–OHLIN–SAMUELSON (HOS) MODEL OF TRADE) argues that free trade leads to a reduction in differences in returns to factors of production, such as land, labour and capital, both within and between countries. Thus liberalization of trade should, for example, tend to raise wage levels in poorer countries towards the wage levels enjoyed in richer countries.

Consider two goods, 1 and 2, each produced from labour and capital in two countries, A and B. Country A has relatively abundant labour (that is, a low capital/labour ratio), while Country B is relatively better endowed with capital (a high capital/labour ratio). With this pattern of factor endowments and no trade between the countries, the ratio of wages to rate of return on capital (w/r) will be higher in Country B than in Country A, since returns will tend to favour the relatively scarce factor in each country.

Suppose that production of Good 1 is labour-intensive, while that of Good 2 is highly automated and requires only low labour inputs. The ratio of prices of the Goods 1 and 2 will be lower in Country A than in B (that is, $P_{1A}/P_{2A} < P_{1B}/P_{2B}$), since Good 1 uses more of the factor that is relatively cheap in A.

Now, with free trade allowed between the countries, the relative prices of each of the individual goods converges to the 'world price'.

But, assuming that the countries use the same production technologies, with equal labour and capital inputs needed to produce one unit of Good 1 (and similarly for Good 2), price equality implies equal returns in both countries to each of the factors of production – that is, equalization of returns to factors of production. Country A continues to produce relatively more of Good 1 and B of Good 2. But now some of A's production of Good 1 is absorbed by Country B, which effectively appropriates the output of some of A's abundant labour.

In tending to differentially push up returns to factors employed intensively in a country's exports and reducing returns relatively to factors employed heavily in the production of imported goods and services, trade should also tend to reduce anomalous discrepancies in returns to different factors *within* a country.

Casual observation, of course, reveals that factor price equalization between nations has not occurred in the real world. It could be argued that this is at least partly due to the fact that trade is rarely totally 'free' in the sense assumed in this analysis. But there are several other idealized assumptions in the model which are unlikely to be realized in practice. For example, differences in skill levels and technological availabilities between countries can make it impossible for those less well endowed to operate as efficiently in producing similar products. The above analysis also assumes that internal markets will ensure that returns duly accrue to factors of production and are not appropriated by powerful forces, such as governments or foreign multinational corporations (MNCs).

JOHN CLARK

equilibrium theory

Three main analytical approaches have dominated the history of economic theory. These are the classical theory of the surplus, ranging from William Petty to KARL MARX; the theory of GENERAL EQUILIBRIUM, founded in 1874 by Léon Walras, and the theory of income and

employment determination, developed by JOHN MAYNARD KEYNES during the 1930s. In this context, modern mainstream 'equilibrium theory' is, in part, an attempt to reabsorb Keynes' ideas.

The first two strands represent the core of nineteenth-century economic culture. Classical economics endeavoured to find the *laws* governing production and distribution in a society based on private accumulation and on the competition between capitals, whereas general equilibrium thinkers aimed at constructing a theory of complete market interdependencies based on *rules* of individual maximizing behaviour. The notion of equilibrium, attained by means of PERFECT COMPETITION engendered by utility-maximizing agents, is the central feature of the marginalist school of which general equilibrium theory is a major component.

Classical economists (such as ADAM SMITH, DAVID RICARDO and Marx) believed that a system in which labour produced commodities by means of other commodities, displayed regular tendencies towards a uniform rate of profits because of competition. The latter meant the free movement of CAPITAL without any institutional or technological barrier to entry and exit. The absence of barriers entailed firms that were able to access cost-minimizing techniques of production. Hence, CAPITAL MOBILITY was thought to eliminate any extra profit caused by innovations. Classical equilibrium can be defined, therefore, as the formation of a long-run rate of profit ensuring the regular expansion of the stock of capital (Walsh and Gram, 1980). The macro-economic role of a uniform rate of profit is evident in the reproduction schemes developed by Marx in the second volume of *Capital*, which constitute the first model of equilibrium growth based on a capital- and a consumption-goods sector. Since the two sectors need each other for inputs and wage goods, they should grow apace. The uniform rate of profit hypothesis suggests just that (Sweezy, 1968).

The idea of equilibrium as the main organizing concept of a static theory was put forward by the marginalist school after the 1870s. The

marginalists adopted the same method as the classical economists, whereby (in the long run) competition requires a uniform rate of return on all capital goods. Yet the analysis of production and of accumulation was not supposed to alter the results of the pure exchange model. In fact general equilibrium theorists, from Walras to the moderns, never succeeded in obtaining a long-run dynamic equilibrium. It is in this context that the method of partial equilibrium, presented by ALFRED MARSHALL, must be considered (Marshall, 1920).

Partial equilibrium theory is concerned with the position of the single firm within the industry. With regard to the hypotheses about individual behaviour, there is no difference *vis-à-vis* the general equilibrium approach. However, for Marshall, the interdependence of markets was a phenomenon too complex to be dealt with successfully by means of a theory in which neither uncertainty nor historical time played any role. Thus he preferred a *short period* method of normal equilibrium, with its focus on the impact of a change in demand or costs on the position of the firm. In his short-run analysis, the stock of capital is taken as given, so that whenever demand rises, the firm's output will expand at increasing costs. The new equilibrium price will therefore be higher than the previous one.

Marshall sought to explain the interaction of supply and demand in a given industry by allowing variations in output and price. In the general equilibrium framework, by contrast, quantities are given and prices emerge as the solution to the allocation problem.

Each individual possesses a set of given endowments that, along with their price list, form that individual's budget constraint. Individuals make consumption choices between different commodities by maximizing their utility which, therefore, rises at a diminishing rate. The equilibrium of the consumer is attained when the price ratio between any two commodities is equal to the ratio of the marginal utilities. This construction is based on the hypothesis that, when prices vary, substitution in favour of cheaper goods will

occur. With a given quantity of goods in existence, their relative prices depend – contrary to classical theory – purely on demand conditions and not on the cost of production. At this point, if individual demand functions can be added together by means of a utility index, it is possible to obtain an aggregate demand function for each of the existing commodities. It follows that a general equilibrium for all consumers may indeed exist.

The marginalist notion of equilibrium conveys the image of a population formed by equal and free agents who voluntarily engage in trade without having any specific power to manipulate prices. In fact, in order to eschew the problem of the starvation of the consumer that arises whenever individuals are compelled to sell their endowments in order to survive, the theory assumes that each person has sufficient resources to subsist without exchanging them in the marketplace. Moreover, the fact that consumers can maximize utility, as much as producers can maximize profits under a resource constraint, implies that there is mutual consistency in the pursuit of self-interest by many different agents. Hence, at least in principle, a perfectly competitive equilibrium may be viewed as a desirable outcome of the process of exchange. In particular, it was thought that a general competitive equilibrium in the allocation of a given set of resources would entail unambiguously the simultaneous clearance of all markets, including the labour market.

Naturally, trading agents may form coalitions, thereby upsetting the competitive outcome. Following an intuitive argument by Edgeworth (1881), modern theory has shown that coalitions can be avoided only if the number of traders is very large. Indeed the formalism requires that it approximate to infinity. In this way, the impact of any single agent's action will be negligible on the rest of the population (Eatwell, Milgate and Newman, 1989). Paradoxically, this logical result eliminates the importance of the individual in a theory which is centred on individualistic behaviour.

Modern equilibrium theory has succeeded in

obtaining precise results thanks to a change in the traditional notion of long-run equilibrium that led to the model of intertemporal equilibrium of Arrow and Debreu (1954) and to Hicks' temporary equilibrium (1939). Both strands have abandoned any attempt to establish a full equilibrium in which competition equalizes the rate of return. In the intertemporal model, decisions are taken once and for all for the entire lifespan of agents. Markets may clear, but there is no presumption that a uniform rate of return will emerge, nor that the ensuing equilibrium is unique or stable. In the Hicksian case, the flexibility of prices needed to equilibrate supply and demand occurs in a very short period. It follows that the stocks of capital installed in each sector cannot instantaneously adjust to the requirements of a uniform rate of return (Garegnani, 1976). The hallmark of the very concept of competition – the uniformity of the rate of return – is obliterated altogether. At the same time, there can be several forms of equilibria – many of which are purely conjectural.

The discovery of many kinds of equilibria has led to viewing Keynes' theory as just a particular subset of Walrasian theory. The Hicksian flexible-price temporary equilibrium approach has been transformed into a set of fixed-price equilibria. Walrasian equilibrium is thereby truncated into a number of cases where quantity rationing in labour and/or goods markets replaces price flexibility. Unemployment stemming from less than full capacity output is then due to a faulty price system.

Yet these interpretations have very little to do with Keynes, for he viewed micro-economic efficiency as separate from macro-economic efficiency (Pasinetti, 1987). In Keynes' own words: 'I see no reason to suppose that the existing system seriously misemploys the factors of production which are in use', so that it is 'in determining the volume, not the direction, of actual employment that the existing system has broken down' (Keynes, 1936: 379).

A notion of equilibrium consistent with Keynes' principle of effective demand has been recently put forward in a dynamic fashion by Luigi Pasinetti, a major representative of the

CAMBRIDGE SCHOOL (Pasinetti, 1993). In this novel approach, the rate of technical change determines the increase in per capita incomes which, in turn, leads to the expansion of per capita expenditure. A macro-economic full employment equilibrium is attained when the sums of all per capita demands require an amount of labour equal to the available working population. However, technical change cannot be expected to be identical across sectors, nor will the growth in per capita demand be equally spread over the entire range of commodities. Hence, in the aggregate, there is no reason to assume the fulfilment of the full employment condition. This result does not depend on faulty price mechanisms, but on the non-uniform character of the process of structural dynamics which may cause a deficiency of effective demand.

See also:

diminishing returns; equalization of returns to factors of production; Keynesian economics; Marxian economics; neo-classical economics, critique of; Sraffian economics

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JOSEPH HALEVI

equilibrium trap, low-level

The theory of the low-level equilibrium trap is an attempt to explain the relationship between population and income growth. Rapid population growth is often seen as a constraint on development and the theory argues that as long as per capita income remains below some critical level, a population growth rate that is greater than the income growth rate will always return the economy to a low-level equilibrium trap. The theory is based on two propositions (Myint, 1964): (1) the Malthusian view that population will increase when per capita income rises above the 'minimum subsistence level', until it reaches its upper physical limit (perhaps 3 per cent per annum); (2) the Keynesian proposition that savings are a function of income and that, at low-levels of per capita income, people are too poor to save and hence invest (see KEYNESIAN ECONOMICS). As per capita income rises above the critical minimum at which savings are zero, a rising proportion of total income will be saved and invested, thus leading to a higher rate of economic growth.

The low-level equilibrium trap is illustrated diagrammatically in Figure 3. The *pp* curve represents the relationship between population growth and per capita income. The *yy* curve represents the rate of growth of aggregate

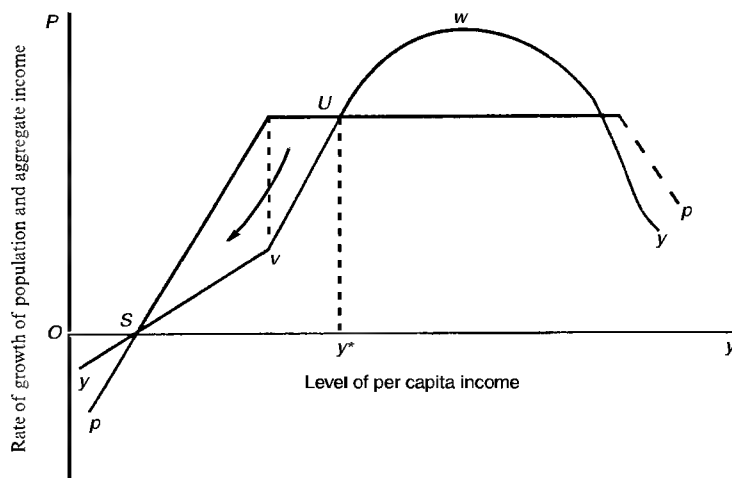


Figure 3 The low-level equilibrium trap

Source: Ingham, 1995, p. 125

income. Point s on the horizontal axis represents the minimum subsistence level of per capita income. Below s , the rate of growth of income is negative (people are 'consuming their capital') and population is decreasing. To the right of s , per capita income rises above the subsistence level. Savings become positive and aggregate income grows. Population growth reaches its maximum and levels off, at which point (v) the growth of income accelerates.

The area between s and u represents the low-level equilibrium trap. The pp curve lies above the yy curve and per capita income is pushed down to its subsistence level s . This is sometimes referred to as the vicious circle of poverty. To break out of the trap, per capita income must jump by more than su , at which point the rate of growth of aggregate income is above the rate of growth of population. This cannot be achieved by a series of small steps. Rather a 'critical minimum effort' or 'big push' is required.

The pessimistic prognostications of the low-level equilibrium trap and vicious circles have not in general been borne out in practice. The precise relationship between population growth, income growth and per capita income

are more complex than the theory suggests. Capital accumulation and technical progress have led to rates of income growth far exceeding population growth. Whether low-level equilibrium traps have any historical validity or contemporary significance remains an open question.

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FREDERICK NIXSON

equities

An equity, or common stock, represents a share in the ownership of a company. The equity shareholders jointly own the company and have the right to vote at general meetings. They are

entitled to dividends, but only after all other creditors have been paid, and if the company makes a loss, the value of their shares fall.

See also:

capital markets

L.S. TALANI

ETATISM *see* statism

ethnicity

'Ethnicity' is derived from the Greek word *ethnos*, which means a number of people living together. Ethnicity is objective or subjectively believed consanguinity and may become a basis of group formation, giving rise to the ethnic group. Thus defined, ethnicity can bind people into a community by the force of sentiments of solidarity and obligation normally felt towards members of the same family, lineage or descent.

Ethnicity is an ascriptive property of persons and indicates a person's social and cultural identity. However, from a more analytical point of view, scholars disagree as to whether ethnicity is a property of a person or a group. For T.H. Eriksen (1993), ethnicity indicates the relationship of an individual to a group formed on the principle of kinship. This relational definition contrasts with the view of ethnicity, proposed by N. Glazer and D.P. Moynihan (1992), as 'the character or quality of an ethnic group'. A person can become a member of an ethnic group either through marriage, adoption or birth into that group. Such mechanisms of inclusion limit the exercise of individual choice and oppose the rational mechanisms employed by bureaucracies and many modern multi-ethnic states in determining citizenship.

Ethnicity as consanguinity with members of an ethnic group defined as a more or less endogamous, historico-cultural community, associates and indeed identifies a person with the values and institutions of that group. The

conception of ethnic groups as makers and carriers of unique cultural values, and the view that these values are existential resources which must be preserved, dates back to the German Romantics and particularly to Johann Gottfried Herder. Herder stressed the importance of language as the vehicle for the distinctive systems of value whereby 'nature' divided humanity into the groups that we call 'nations'.

Ethnicity can be real or imputed, depending more on the social belief in genetic affinity than on the objective existence of consanguinity. People may derive their sense of genetic affinity and feelings of kinship 'backwards' from other forms of affinity, such as shared physical appearance, language, religion, custom, conduct of life or political community, which may be perceived as consequences of kinship, of a life in common in a recent or distant past. However, with the possible exception of physical appearance or RACE which (by virtue of its biological nature) may be perceived as congruent with and signalling the otherwise invisible blood relationship, these traits, in their particular manifestations, are not exclusive properties of particular ethnic groups and can be independent group-forming factors. Ethnicity is thus not identical to culture or statehood. Languages (such as English or Portuguese), world religions (such as Christianity and Islam) and states (such as Belgium or Nigeria) may divide or encompass more than one community of common descent. On the other hand, social isolation or prohibition of exogamy (that is, marriage outside the language group) or, more often, the faith or the boundaries of the state may, in the long run, create an ethnic group.

The importance of ethnicity *vis-à-vis* these other principles of association, such as cultural and political affinity, is an empirical question. Nevertheless, ethnicity may override cultural similarity and divide culturally similar groups, such as the Serbs and Croats during the 1991 war in the former Yugoslavia. Ethnicity may also override allegiance to the state, especially in the case of repressed ethnic minorities in multi-ethnic states, such as the Ukrainians and Lithuanians during World War II with regard

to the Soviet state. Similarly empirical is the question of the relationship between ethnicity and other personal identities and loyalties, such as gender, political party or class.

Ethnicity as a group-generating principle, as the crucial factor in ethnogenesis (the making of nations), has been studied extensively by social scientists. The extent to which ethnicity is a primordial, symbolic or circumstantial principle of group formation has been a source of academic controversy, but with implications beyond the academic groves into the political realities of ethnic conflict. There is no doubt that ethnicity is a perennial phenomenon, observable both in the tribal forms of human association which go back into the mists of time and in the modern, large-scale and bureaucratically organized NATION-STATE.

The primordality of ethnicity in human affections was stressed by Clifford Geertz who, following Edward Shils, distinguished ethnic from civic ties, noting the primacy of the former over the latter and its disintegrating effects on the multi-ethnic post-colonial states of Asia and Africa. Walker Connor has explained the 'national bond' – the fact that 'People of the same blood attract!' (1994: 203–4) – as a fact of the unconscious, non-rational, emotional side of humanity. To this broad school of social scientists who view ethnicity as a constant and universal principle of association, belongs Pierre van den Berghe. He represents the sociobiologists' attempt to explain 'nepotism' as an objective, biological imperative. The human attachment to the ethnic group – that is, kin selection – serves the need, shared by all living organisms, for genetic self-replication. Darwin called this need 'fitness' in the sense of reproductive success. In the struggle for survival into the next generation, cultural/behavioural and phenotypic affinities are taken as tags of genetic affinity and their carriers are selected for 'sociality' – social intercourse.

According to Anthony D. Smith, ethnicity in modern societies is 'largely "mythic" and "symbolic" in character', but no less powerful and necessary than actual ethnicity (Smith, 1986: 16). Ethnicity has become symbolic

because, with few exceptions (such as Iceland), most modern, culturally homogenous states contain several genetic strains. Nevertheless, social cohesion, political allegiance and the cultural life of modern people are still nurtured by myths of common origin which turn the citizens of the modern and allegedly rational state into members of a super-family, into 'brothers' and 'sisters' with 'forefathers' and a 'motherland'. Such beliefs are transmitted from one generation to the next through various forms of artefacts, public ceremonies and collective activities, all of which project the idea of a common past and answer one of the perennial problems of life: the question of origins.

Fredrik Barth has made one of the most influential anthropological contributions to the circumstantial approach to ethnicity. Barth applied a 'generative' and 'relational', rather than a typological and content-oriented viewpoint, to the study of ethnicity. He focused on 'the different processes that seem to be involved in generating and maintaining ethnic groups' (Eriksen, 1993: 38). According to Barth, contact with other groups produces ethnicity in the sense of the formation of *social* boundaries between ethnic groups. The ethnic boundary 'canalizes social life' into networks of 'us' which exclude 'them'. And although the cultural 'stuff' may change, even in the direction of assimilation, the boundary of social interaction may still be maintained. The cultural 'Creolization' of the population of Indian descent in Trinidad is a case in point.

Among circumstantial approaches to ethnicity, some have associated advanced industrialization with ethnicity's demise. Modernity was expected to erode ethnicity as a principle of solidarity and identity, and replace it either with instrumental rationality and 'Westernization' or with 'Orientalism' and multi-culturalism – the amalgamation or co-existence of different cultural traditions (Gellner, 1983; Said, 1985; Rex, 1995). Furthermore, Marxist theorists expected class to be the major principle of human association, as well as cleavage, in modern society (Hobsbawm, 1990). However, the 'ethnic revival' which has been

observed since the 1960s in all parts of the world, including the United States and the former communist bloc, refuted such expectations as the 'melting pot' – the fusion of all cultures into a single, homogenous, super-culture – was replaced by the 'cauldron of ethnicity' – ethnic assertiveness – as a metaphor for our time (Glazer and Moynihan, 1992; Nash, 1989). Nevertheless, Marxist scholars tend to reduce ethnicity to class and explain the contemporary proliferation of ethnic organizations and pressure groups, and modern ethnic conflict, as the response of ethnic groups to their material circumstances of economic deprivation and exploitation 'rather than a spontaneous stirring of people' fostering the values of the group into which they were born (Cashmore, 1996: 123). RATIONAL CHOICE theorists of ethnicity, such as Michael Banton, have also pointed to the variability of ethnic alignment and thereby the dependency of this alignment on circumstances – namely, the opportunities which ethnicity offers to individual actors for wealth, power and prestige (Banton, 1994).

Ethnicity is closely associated with the modern doctrine of NATIONALISM. Nationalism, as the demand for the preservation and self-determination of historico-cultural communities, ultimately transforms ethnicity into citizenship. As Roger Brubaker has shown, the idea of a kin-based polity is as relevant to modern citizenship law as it was in the ancient city-state of Athens (Brubaker, 1992). The German citizenship system of *jus sanguinis* and the Constitution of the state of Israel are cases in point. The persistence of ethno-nationalism – namely, the insistence on ethno-cultural homogeneity and biological continuity within European states alongside the civic and more pluralist and universalist variety of nationalism – may appear paradoxical in the context of European integration and the flow of populations which is associated with it.

Ethnicity is Janus-faced. If ethnicity creates ties that bind, it also creates swords that divide. Ethnic affiliation necessarily involves ethnic discrimination. And this is illegal under international, United Nations (UN) law. The

politicization of ethnicity has transformed it into, on one hand, a principle of state-formation and, on the other, a set of corporate and individual rights for ethnic groups ('minorities') and their members within multi-ethnic states. Looked at from the outside, there is an irony in national and international norms regarding ethnicity; for these norms seem both to foster and condemn ethnicity and ethnic selection – 'nepotism'. But as Glazer and Moynihan have observed, nothing illustrates better than this apparent contradiction the human need not to exclude but to preserve, and 'the validity of some degree of discrimination'. The only danger lies in the fact that 'the acts that serve one aim [to exclude] are hard to distinguish from the acts that serve the other [to preserve]' (Glazer and Moynihan, 1992: xxxviii–xxxix).

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EURATOM

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ATHENA S. LEOUSSI

EURATOM

An abbreviation for the European Atomic Energy Community, set up by the TREATY OF ROME in 1957. Its main objective has been the promotion of cooperation between member states in research and development (R&D) in the nuclear field. The relevance of EURATOM waned as emphasis on the production of nuclear energy diminished.

OSVALDO CROCI

Eurocentrism

Eurocentrism is the belief that European (or Western) civilization is the culmination of social evolution, the highest stage of progress in human rationality, prosperity and morality. Critics of Eurocentrism such as Samir Amin, ANDRE GUNDER FRANK and Edward Said agree that Western social sciences have been constructed around understanding the 'unique' rise of industrial capitalism and democracy in the West, thus conceptualizing other peoples and civilizations in terms of what they lacked relative to the West and transforming them into an undifferentiated 'other' lacking cultural diversity and history. These critics insist that only by recognizing that the history of the world is one of cultural emulation and interdependency, can we overcome Eurocentrism and view the world as a polycentric place.

See also:

Asiatic mode of production: ethnicity; world culture

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RICARDO DUCHESNE

eurocurrency market

The term 'eurocurrency' refers to bank deposits that are denominated in a currency other than that of the country in which they are located. At the beginning, the market involved the holding of US dollars in Europe and consequently the term 'eurodollar' was used. This market originated in the 1950s with, ironically, Soviet concern about the vulnerability of their dollar holdings in the United States. It was more significantly stimulated at this time by the desire of British firms to evade British controls over cross-border flows of sterling. During the 1960s, the market continued to grow rapidly, spurred by the desire of US depositors to escape US interest-rate ceilings and the desire of US firms to counter efforts by the US government to control capital outflows. The market grew from an estimated gross value, in US dollars, of \$20 billion in 1964 to \$110 billion in 1970, and had reached \$2,146 billion by 1982 (Sarver, 1992). (The broader term 'euromarkets' is used to refer not just to bank deposits but to BONDS, EQUITIES, COMMERCIAL PAPER and DERIVATIVES – further discussion of these activities and of the political significance of the EURO-MARKETS can be found in that entry).

The 1970s was a period of enormous growth and change for the eurocurrency markets. The breakdown of the Bretton Woods monetary

system at the beginning of the decade (see BRETTON WOODS SYSTEM) led to high volatility in exchange rates (see EXCHANGE RATE) and many banks were lured into international markets by the prospect of huge profits from currency transactions. In 1974, the collapse of the Franklin National and Herstatt banks as a result of their international transactions alerted regulators to the risks involved in the relatively unregulated eurocurrency markets. The large percentage of inter-bank deposits in these markets exacerbated the dangers of financial distress spreading from one bank to another and the absence of a single LENDER OF LAST RESORT made a regulatory response more difficult. Such concerns led the GROUP OF 10 (G-10) central bank governors to create the BASLE COMMITTEE ON BANK SUPERVISION in 1974 and to initiate, through that committee, a process of regulatory and supervisory cooperation.

The 1973 oil shock also had a tremendous impact on the eurocurrency markets. Oil exporting countries, unable to immediately find profitable domestic uses for the sudden huge inflow of dollars that they experienced, deposited these PETRODOLLARS in the eurocurrency markets. The oil exporters were enthusiastic about the flexibility of short-term EURODOLLAR deposits and some also welcomed their relative lack of susceptibility to the risk of seizure by the US authorities. At the same time, developing countries facing an unexpectedly high bill for oil imports began to borrow heavily from the eurocurrency markets. In addition to being a source of plentiful dollars, borrowing from commercial banks seemed to these countries to come with fewer strings attached than the relatively scarce official funds that could be obtained from public institutions such as the INTERNATIONAL MONETARY FUND (IMF) or WORLD BANK. This process of 'petrodollar recycling' – and its apparent ability to respond to the turbulence initiated by the oil shock – was seen by many at the time as a testament to the virtues of the euromarkets.

The 1980s was a difficult decade for banks involved in the eurocurrency markets. The most critical challenge was the DEBT CRISIS.

During the 1970s, the lending involved in the petrodollar recycling was further encouraged by the banks' assumption that sovereign borrowers could not go bankrupt. In the inflationary environment of that decade, real interest rates were very low or even negative and thus it was not difficult to find apparently viable projects in developing countries to finance. The abruptly tighter monetary policy and higher interest rates initiated by the Federal Reserve in 1979 and the related recession at the outset of the 1980s dramatically altered the viability of particular projects and of the developing countries' debt load more generally. The Mexican government's warning in August 1982 that it was about to default signalled the arrival of the debt crisis.

Viewed initially by many as a short-term liquidity problem, it eventually became apparent that the debt crisis had potentially disastrous implications for the indebted countries and for the international financial system. Given the heavy exposure of very large banks and the interdependence of the banking system, a generalized financial collapse seemed a very real possibility. Ultimately solidarity was fostered between banks with the help of the IMF, the US government and the structure of existing syndication arrangements. The major banks also established, in 1983, the Institute of International Finance, the primary purpose of which has been to develop and share information about sovereign borrowers.

The debt crisis was related to a longer range competitive challenge faced by commercial banks from securities markets. Traditionally a bank has created value by intermediating between dispersed and relatively small short-term depositors and larger longer-term borrowers (see INTERMEDIATION). Such intermediation involved expertise in the assessment and monitoring of creditworthiness. As securities markets have become more developed, however, much of this expertise has been taken over by credit-rating agencies (which do not have an interest in the lending business) and by widely available sources of information such as financial newsletters and databases. Large borrowers have found it increasingly

cost-effective to go more directly to investors by selling bonds in securities markets rather than relying on bank loans. The debt crisis reinforced this process of SECURITIZATION: many corporate borrowers found they had better credit ratings than banks and therefore were able to access funds more cheaply than were the banks. International securities market activity exceeded international syndicated loan activity for the first time in 1983. By the mid-1980s, banks had become increasingly heavily involved in new financial instruments that resembled securities (such as note issuance facilities guaranteeing short-term notes), creating concern and encouraging new initiatives to be developed by the regulators at the Basle Committee, who felt that the banks' new activities involved poorly understood risks. The relationship between securitization and the debt crisis was also evident in the importance of the secondary market in bank loans, in the conversion of loans into bonds under the BRADY PLAN and in the enthusiasm in the international financial institutions for securities markets as a tool for financing development in the 1990s. The limitations of securities markets as a mechanism for producing and distributing information were evident in the sharp and potentially disastrous reversal of portfolio capital flows in Mexico in late 1994, and in events in East Asia during 1997 and 1998.

See also:

Baker Plan; Bank for International Settlements (BIS); capital, controls on; capital, internationalization of; capital markets; capital mobility; casino capitalism; convertibility, currency; debt trap; deregulation; disintermediation; financial integration; foreign exchange; forward market; liberalization; money markets; portfolio investments; securities firms; swaps

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TONY PORTER

eurodollar

A eurodollar deposit is one made in US dollars in a US bank, but held outside the United States – for example, a credit account with a bank in New York held by a British bank in London. The term is often misleadingly used to refer to all eurocurrencies. The latter exist to serve similar markets in other currencies. Moreover, it must be noted that the market for eurodollars is not confined to Europe. Rather, the term 'eurodollar' was coined in the 1950s when the practice began with Eastern European bank branches in the main Western European banking centres who, having acquired dollar balances and fearing that they might be frozen if left in the United States, lent them to other Western European parties. Other banks then followed suit, with the practice being aided by the continuing US balance-of-payments deficit that produced a deluge of credit balances that were surplus to the requirements of their holders outside the United States.

A eurodollar transaction begins with, for example, a bank in London, as a result of a commercial transaction of one of its customers, who holds a credit balance with a US bank in New York. A Danish businessman then asks his bank in Copenhagen for dollars in order that he may finance imports from the United States. To do this, the bank must accept the dollar deposit that is transferred by the British bank from its account in New York. The significant issue regarding this transaction is that it creates credit. The bank in London still has a claim, but this time it is on the bank in Denmark rather than that in New York. On the

other hand, the bank in Copenhagen now has a claim on New York that its customer can use in order to finance his imports from the United States.

The eurodollar market has been thought to create credit, in that it produces a succession of bank deposits that can, in turn, generate new advances. In addition, the initial advantage of eurodollar accounts was in their avoidance of exchange transactions and the potential profits to be made as a result of interest rate ARBITRAGE (New York versus Copenhagen). This motive was quickly overtaken, aided by changes in US official exchange controls, by the ease of participation in the international money markets that eurodollars allowed. In the light of this, the absence of any control by national banking authorities has been the cause of some concern. Moreover, there has been considerable debate concerning the issue of whether or not eurodollars actually increase the volume of credit, given that a eurodollar transaction basically entails the movement of the same deposit between banks outside the US banking system. In short, it has been argued that the eurodollar market has increased the velocity, as opposed to the volume, of the US money supply. Nevertheless, the market has been enlarged over the years, with one development being the eurobond market that is used for longer-term loans.

See also:

bonds; exchange rate; globalization; interest rates

ALISON M.S. WATSON

Eurogiro

Eurogiro is an electronic payment system created for private and corporate customers in 1993 by a limited partnership of seventeen European Post/Giro banks. The main consumer benefits of Eurogiro and other similar payments systems like the INTER-BANK ON-LINE SYSTEM (IBOS) and TIPA-NET are the

speed of transfers between accounts in the network and the transparency of charges for transactions. These payments systems further the integration of national economies within Europe by reducing barriers to cross-border trade. In an effort to expand beyond Europe, the Eurogiro Network has formed an alliance with Western Union to bring its services to the US market.

CAMERON G. THIES

euromarkets

The term 'euromarkets' refers to a range of financial transactions for which the financial instrument involved is denominated in a currency other than that of the country in which it is located. The euromarkets initially almost exclusively involved the deposit of dollars in banks in Europe. The bank deposit segment of the euromarkets is referred to as the EUROCURRENCY MARKETS and is discussed primarily under that entry. After briefly discussing the other segments of the euromarkets, this entry focuses on their overall political significance.

The wide variety of financial instruments now available in the euromarkets is a sign, along with estimates of these instruments' value, of the rapid development of the market. After bank deposits, eurobonds were the first instrument to exhibit a significant presence in the euromarkets. Eurobonds are generally dated from a 1963 dollar-denominated issue for Autostrade, the operator of Italian motorways. Total international bond issues grew from \$3.2 billion in 1965 and had become very well established by 1986 at \$225.4 billion. During the 1980s, there was an explosion of new financial instruments, including note issuance facilities, interest rate and currency swaps and options, and forward rate agreements. Short-term euronotes, including COMMERCIAL PAPER, became increasingly popular. International equity offerings also began to appear, increasing from \$200 million in 1983 to \$11.8 billion only three years later. In 1995,

ORGANISATION FOR ECONOMIC CO-OPERATION AND DEVELOPMENT (OECD) statistics indicated that syndicated loans accounted for 29.2 per cent of major international financing instruments, straight bonds accounted for 27.5 per cent, medium-term euronote programmes for 27.1 per cent, with much smaller proportions distributed among other instruments.

The international political economy literature has explored a variety of questions involving the relationship between states and the euromarkets. Have the euromarkets grown so large that state power and autonomy have been fatally compromised? Are the euromarkets the unregulated exemplar of free markets suggested by their supporters? Can, or should, cross-border CAPITAL MOBILITY – to which the euromarkets have contributed – be constrained?

The prevailing popular view is that the euromarkets have become so large and sophisticated that they cannot be controlled by states. This view is generally supported by financial services industry participants and by liberal economists. Such arguments are made in *Quicksilver Capital* (1991) by Richard McKenzie and Dwight Lee, who suggest that international capital markets, by constraining inherently oppressive states, represent an unstoppable expansion of individual freedom. Some IPE scholars have made similar arguments about the constraints imposed by global financial markets on states, but without the positive evaluation of the effect of this process that is characteristic of McKenzie and Lee. For instance Stephen Gill and David Law (1989) highlighted the enhanced STRUCTURAL POWER of capital that resulted from capital mobility, but framed this in Gramscian terms as strengthening the hegemony of transnational capital. Phil Cerny (1993) identifies the COLLECTIVE ACTION problems that appear in the regulation of global finance: each individual state can attract financial market activity by providing a relatively light regulatory regime.

A number of IPE scholars have challenged the view that the growth of the euromarkets signifies the increasing irrelevance of state regulation. In *Casino Capitalism* (1986) and elsewhere, SUSAN STRANGE – while acknowl-

edging the turbulent character of international financial markets – has argued that states, and the US government in particular, have been responsible for financial GLOBALIZATION, in part through a set of ‘non-decisions’ in which opportunities to regulate were eschewed. Moreover, regaining control is possible: ‘Only provided that the United States were to recognize the advantages in its own national interest of having a stable and reliable international financial system, it would not be too difficult to work out the means and mechanisms for the purpose’ (Strange, 1986: 171). Louis Pauly (1988) carefully analyses the political process in key countries which resulted in financial liberalization and also highlights the continued dependence of banks on the legal and political framework provided by states. Eric Helleiner (1994) has traced the central role of states in bringing about the euromarkets. For instance, the UK government perceived the euromarkets, which were permitted to operate in London, as a way to retain a leading role for the United Kingdom in global finance. In the 1960s, the US government also encouraged the euromarkets as a means of financing external deficits and promoting the interests of internationally oriented US firms. The political significance of the distributional consequences of globalization has also been highlighted by IPE scholars. Geoffrey Underhill, in his introduction to an edited volume on global finance, has noted that ‘different markets are institutions created through political interaction which confer relative benefits on some and costs upon others’ (Underhill, 1997: 4).

IPE scholars have also highlighted new regulatory initiatives by states – initiatives that are often overlooked by those that stress the freewheeling nature of the euromarkets. The BASLE COMMITTEE ON BANK SUPERVISION, for instance, has developed and implemented common standards of capital adequacy that seek to offset the ‘race to the bottom’ that results from competition among regulatory jurisdictions (see CAPITAL ADEQUACY STANDARDS). Ethan Kapstein (1994) has emphasized the role of political power – of states in general and the United States and the United

Kingdom in particular -- at the Basle Committee in pushing the capital adequacy negotiations forward, and has also noted the degree to which the Basle Committee's emphasis on home state regulation enhances the control of states over banks. Tony Porter (1993) has stressed the developing autonomy of the regime -- centred on the Basle Committee -- for regulating international banking, and for international securities, centred on the International Organization of Securities Commissions. Cerny (1993) has emphasized a trend of 're-regulation' that has accompanied the globalization of finance, although he has noted that much of this re-regulation is designed to enhance the functioning of markets, rather than constrain them.

See also:

Baker Plan; Bank for International Settlements (BIS); bonds; Brady Plan; Bretton Woods system; capital, controls on; capital, internationalization of; capital markets; casino capitalism; convertibility, currency; credit; debt crisis; debt trap; debt-equity swaps; deregulation; derivatives; disintermediation; financial integration; foreign exchange; forward market; liberalization; money markets; portfolio investments; securities firms; swaps

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TONY PORTER

European Bank for Reconstruction and Development (EBRD)

The youngest of the regional development banks, the EBRD was established in 1990 to

European Central Bank (ECB)

advance market principles in former 'Eastern bloc' countries. The EBRD has its headquarters in London and is structured in a similar way to other regional development banks. Yet, unlike the other regional development banks, the EBRD is explicitly concerned with advancing a political agenda: namely, the promotion of democratic principles in former communist countries. Due in large part to its political mandate, the EBRD's board of directors is much larger than that of other regional development banks, comprising twenty-three members. Indeed, the EBRD at the time of its formation had more members on its board of directors than the WORLD BANK (a much larger institution in terms of membership and capital) has on its executive board. Apparently, members of the EBRD are very concerned with having their voices heard and therefore in the negotiations leading to the EBRD's formation many actors were able to negotiate representation on the board of directors. The EBRD also differs from other regional development banks with regard to how it is embedded in a system of well-established institutions in Europe.

JONATHAN R. STRAND

European Central Bank (ECB)

The European Central Bank (ECB) was created under the terms of the Treaty on European Union or MAASTRICHT TREATY. The ECB is joined by the national central banks of the EUROPEAN UNION (EU) member-states to form the European System of Central Banks (ESCB); this system is intended to govern monetary affairs within the EU's ECONOMIC AND MONETARY UNION (EMU). The ECB and ESCB are therefore both organizations of the EU; each has, however, its own legal personality and each is legally forbidden from either seeking or taking instructions from any other EU institution. Furthermore, the legal membership of the ESCB does not consist of the national governments but rather of the central banks of the EU's member-states. These provisions, together

with various measures to secure the tenure of the governors of the national central banks and of the Executive Board members of the ECB, are intended to provide the new monetary system with an unprecedented degree of formal independence from political authorities.

The ECB was established shortly prior to the transition to the third and final stage of EMU, which occurred on 1 January 1999. The ECB is the direct successor of the European Monetary Institute (another creation of the Maastricht Treaty), which in turn was intended to take over many of the functions of the Committee of Governors of Central Banks of the Member States of the EUROPEAN COMMUNITY (EC). The following paragraphs outline the historical origins of the ECB, followed by a brief description of its organization.

The Committee of Governors was created in 1964 to facilitate cooperative monetary policy decision-making among the Community's central banks. The Committee began to play a central role in European monetary affairs in the late 1960s and early 1970s, when the BRETTON WOODS SYSTEM came under increasing strain. (For example, the Committee was charged with responsibility for the functioning of the European currency 'snake' and later the EUROPEAN MONETARY SYSTEM (EMS).) The Maastricht Treaty, which aimed at further centralization of European monetary affairs, came into effect on 1 November 1993, calling for the functions of the Committee of Governors to be transferred to a European Monetary Institute (EMI) at the beginning of Stage Two of the phased introduction of EMU. A special summit of Community heads of state and government on 29 October 1993 decided to base the EMI – and consequently the European Central Bank – in Frankfurt in Germany.

The EMI was formally established according to schedule: in accordance with the provisions of the Treaty and of the accompanying EMI statute, the first president of the EMI, Alexandre Lamfalussy, was appointed for a three-year term beginning on 1 January 1994. At that point, however, the new institution had no facilities and virtually no staff. The first actual meeting of the EMI Council – a body with the

same composition as the former Committee of Governors, plus the president of the EMI – did not take place until 15 November 1994.

During Stage Two of the EMU process, the treaty called for the EMI to strengthen cooperation between the central banks of the EU's member-states, to monitor the functioning of the EMS, to facilitate use of the EUROPEAN CURRENCY UNIT (ECU) and to 'prepare the instruments and the procedures necessary for carrying out a single monetary policy in the third stage' of EMU. Until the commencement of Stage Three, however, monetary policy was to remain a prerogative of national monetary authorities.

On 2 May 1998, the European Council agreed that eleven of the fifteen EU member-states – Austria, Belgium, Finland, France, Germany, Ireland, Italy, Luxembourg, the Netherlands, Portugal and Spain – would move forward to Stage Three of EMU beginning on 1 January 1999. The governments of these eleven states then selected six officials to form the Executive Board of the new ECB. Willem F. Duisenberg (former governor of the Dutch central bank, twice Chair of the Committee of Governors and successor to Alexandre Lamfalussy at the head of the EMI) was named the ECB's first president. The appointment of Duisenberg and his five colleagues on the Executive Board was made effective on 1 June 1998; thus the ECB was formally established just seven months prior to the transition to Stage Three of EMU.

The six members of the ECB's Executive Board were joined by the eleven governors of the national central banks participating in the third stage of EMU on the chief decision-making body of the new system – the Governing Council of the ESCB. The Governing Council body is responsible for the formulation of monetary policy within the area covered by the single currency (the so-called 'Eurozone' or, more informally, 'Euroland'), whereas implementation remains the responsibility of the Executive Board. A third governing body, the General Council, consists of the President and Vice-President of the ECB (but not the other four Executive Board members) and the

governors of all the central banks of EU member-states, including those not participating in the single currency. The General Council's duties are limited, however, chiefly to advisory and management functions, and do not extend to either monetary policy formulation or implementation.

See also:

European Economic Community (EEC); Exchange Rate Mechanism (ERM)

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DAVID M. ANDREWS

European Coal and Steel Community (ECSC)

The European Coal and Steel Community (ECSC) was the first, the most supranational and the most dirigiste of the three European

European Commission

Communities to be created. It was established by the 1951 Treaty of Paris, which came into effect in July 1952 for a period of fifty years. Based on the 1950 SCHUMAN PLAN, the treaty provided for the creation of a common market in the coal and steel sectors in the signatory states: Belgium, France, Italy, Luxembourg, the Netherlands and West Germany. Four main institutions were created: a supranational High Authority, overseen by an intergovernmental Special Council of Ministers, an indirectly elected European Assembly and an independent Court of Justice. Following the 1957 Treaties of Rome and the 1965 Merger Treaty, they became the Commission, Council, European Parliament and European Court of Justice respectively, common to the three European Communities but operating according to the rules laid down in the Treaty of Paris when dealing with ECSC business. Under the Treaty of Paris, the ECSC's Commission is charged not only with regulating the coal and steel markets in the member-states, but also with improving the living and working conditions of the labour force in these sectors.

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FIONA HAYES-RENSHAW

European Commission

Probably the most famous of the institutions of the EUROPEAN UNION (EU), the European Commission is in fact by no means its most powerful; that honour lies with the COUNCIL OF MINISTERS. However, it was created to be the engine of European INTEGRATION – a body of experts that would oversee the transformation of the EUROPEAN ECONOMIC COMMUNITY

(EEC) into a federal Europe. Despite its inability to achieve this goal – largely as a result of the persistence of national SOVEREIGNTY and the related determination of the EU's member-states to preserve the powers of the Council – the Commission remains a unique institution. It is a multinational entity, a mixture of executive and civil service, whose top officials (the Commissioners) are appointed by the member-governments (with approval from the European Parliament), but swear an oath of loyalty to the EU. Nonetheless, each member-state has at least one Commissioner and the sincerity of the pledge each makes to work for the EU rather than their member-state varies enormously. The President of the Commission is appointed by the member-states, often after a period of intense bargaining. Each Commissioner has a portfolio, somewhat like national ministers. As a collective, the Commission is accountable to the European Parliament, by which it can be forced to resign. However, the Parliament cannot force individual Commissioners from office. Below this top stratum exists a surprisingly small number of Commission officials – approximately 17,000, including translators – many of whose entire working lives are spent in the EU civil service.

The Commission is tasked with proposing legislation, acting as 'Guardian of the Treaties' and undertaking international negotiations on behalf of the entire EU. It also draws up the EU budget, although it does not have the final say on the matter – that is the task of the Council and Parliament. Its responsibilities relate almost entirely to the first of the EU's so-called 'Three Pillars', which divide the EU's remit into three sections: the European Community (by far the most extensive area), the Common Foreign and Security Policy, and Police and Judicial Cooperation in Criminal Matters. Within this first pillar, the Commission can be extremely influential. No EU legislation can exist without a formal proposal from the Commission, enabling that body to set the EU agenda to a great extent. Moreover, as Guardian of the Treaties, the Commission has the duty of ensuring that all member-

governments implement EU law and it can prosecute recalcitrant states at the European Court of Justice. In its role as external trade negotiator, the Commission can also play a vital role. For example, in WORLD TRADE ORGANIZATION (WTO) negotiations, the Commission represents every member-state of the EU, being considered a neutral representative of the 'European' (rather than national) interest.

The Commission has occasionally been able to provide leadership for the European integration process, particularly under the leadership of President Jacques Delors at the time of the SINGLE EUROPEAN ACT (SEA). However, even since the 1999 reforms, the powers of the Commission President are not extensive and require the office of a skilful politician to be harnessed successfully. Most Commission Presidents have not been able to match the example of Delors, either as a result of opposition from a national leader (in the past, notably Charles de Gaulle) or as a result of cleavages within the Commission.

Even during the last years of the Delors presidency, it became clear that the member-governments were deepening European integration but were not prepared to allow the Commission to develop as a government-in-waiting. Instead, they created the pillar structure in order to prevent the Commission developing significant competences in the newly integrated policy areas. The 1994–9 Commission, under Jacques Santer, thus prioritized streamlining and internal reform rather than bold policy initiatives. Consequently, the Commission had little to point to in its defence when the slow pace of reform, combined with allegations of corruption, sparked its spectacular resignation (in the face of a vote of dismissal by the European Parliament) in 1999. The new Commission President, Romano Prodi, is thus faced with the difficult task of reviving the Commission's fortunes while continuing internal reform. This job will be complicated by relations with the European Parliament, traditionally an ally of the Commission but increasingly critical of it since its own acquisition of greater legislative power.

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ALEX WARLEIGH

European Community (EC)

The European Community (EC) came into existence on 1 July 1967, following the ratification of what is commonly known as the 'Merger Treaty' (signed on 8 April 1965). This treaty established a single COUNCIL OF MINISTERS and EUROPEAN COMMISSION for the three existing communities – namely, the EUROPEAN COAL AND STEEL COMMUNITY (ECSC), the EUROPEAN ECONOMIC COMMUNITY (EEC) and EURATOM. The three communities already shared the European Parliament and the Court of Justice. Although, technically, the Merger Treaty created the European Communities, the singular form 'European Community' was more commonly used. This was probably because, by the end of the 1960s, the EEC had emerged as the most significant of the three and could be said to have all but legally

European Currency Unit (ECU)

incorporated the other two. The MAASTRICHT TREATY has legalized this usage, as it were, by revising Article 1 of the EEC Treaty which now states that 'the High Contracting Parties establish among themselves a European Community'.

As a result of the Maastricht Treaty, the European Community has become part of the EUROPEAN UNION (EU). The primary objective of the Community has been the creation of a COMMON MARKET (a goal fully achieved only in 1992, following the implementation of the programme provided by the SINGLE EUROPEAN ACT (SEA)) and the elaboration and implementation, through Community institutions having a supranational character, of common policies to regulate it. These were originally rather limited (covering primarily competition and market regulation, agriculture, fisheries, and transport) but were slowly extended to include a much larger range of economic and social policies, even if in some fields Community action is limited to giving direction and attempting to coordinate the policies of member-states. The Maastricht Treaty added the objective of establishing an ECONOMIC AND MONETARY UNION (EMU), including a EUROPEAN CENTRAL BANK (ECB) and a common currency known as the 'euro'.

OSVALDO CROCI

European Currency Unit (ECU)

The ECU, a unit of account based on a basket of European currencies, was established in 1979 by the EUROPEAN COMMUNITY (EC) as part of the process which, at the same time, created the EUROPEAN MONETARY SYSTEM (EMS). The goal of the EMS was to enhance monetary stability in Europe: the EMS can therefore be seen as a European response to the collapse of the US-led BRETTON WOODS SYSTEM of exchange rate management. The ECU was set up as a basket of fixed amounts of EC currencies. The EMS required member currencies to fluctuate within set margins around the ECU. The ECU has also been used by the EC

and the EUROPEAN UNION (EU) as a unit of account in its own budget and other financial transactions. Over time, a substantial market in ECU bonds has developed, initially issued by governments but subsequently by corporations as well. By the mid-1990s, the ECU also had begun to be used for retail purposes (checking accounts and traveller's cheques). With the efforts to establish European Monetary Union (EMU) that were initiated with the MAASTRICHT TREATY in 1992, the ECU acquired an added importance as a symbol and economic indicator of the commitment to the unification project.

TONY PORTER

European Economic Area (EEA)

The world's largest economic bloc, the European Economic Area (EEA) comprises the fifteen member-states of the EUROPEAN UNION (EU), plus Iceland, Liechtenstein and Norway. All eighteen states adopt EU single market and competition policy regimes, thereby creating an extended European 'internal' market. The EEA was conceived in the late 1980s as a means of postponing enlargement of the EU to the EUROPEAN FREE TRADE ASSOCIATION (EFTA) countries, while nonetheless reaping many of the economic benefits of such an enlargement. However, the collapse of COMMUNISM in the former Soviet Union and Central and Eastern Europe made it possible for several EFTA states to join the EU, an option which they preferred to simple acquiescence in policies made for them by the EU states. Launched on 1 January 1994, the EEA became largely redundant exactly a year later, when Austria, Finland and Sweden joined the EU. Switzerland voted against joining the EEA in 1992.

See also:

European Union, eastern enlargement of the

ALEX WARLEIGH

European Economic Community (EEC)

Sometimes referred to simply as the 'Common Market', this is the best known and most important of the European communities. After the failure of the European Defence Community in 1954, in an attempt to relaunch the process of European INTEGRATION, the Action Committee for the United States of Europe (an international, intellectual pressure group headed by Jean Monnet, the 'father of Europe') advanced the idea of a European Atomic Energy Community or EURATOM. This project was eagerly embraced by the French government because of the efforts it was devoting to the development of a nuclear industry. The Dutch and Belgian governments suggested instead the creation of a comprehensive economic community. The German government eagerly supported this idea, given that its export-oriented economy was fast emerging as the most dynamic one in Europe. The French, however, were reluctant, because they did not think they could compete on par with the Germans.

Negotiations began at a meeting of the foreign ministers of the six countries that were members of the EUROPEAN COAL AND STEEL COMMUNITY (ECSC) (Belgium, France, Italy, Luxembourg, the Netherlands and West Germany), held in Messina, Italy, on 2-4 June 1955. The British were also invited to participate. They rejected the idea of a common market, because a common external tariff could not accommodate their existing preferential trade links with the Commonwealth, and suggested the formation of a EUROPEAN FREE TRADE ASSOCIATION (EFTA). When this idea was turned down by the six, the British withdrew from the negotiations. The six decided to set up a committee, headed by Belgian Foreign Minister Paul-Henry Spaak, that would evaluate the different options on the table. The Spaak report recommended the creation of both EURATOM and a common market, and then proceeded to draw up the necessary draft treaties. After further negotia-

tions that made additional concessions to the French (namely, provisions for a COMMON AGRICULTURAL POLICY (CAP) and a special association status for their overseas possessions), the treaties establishing the EEC and EURATOM were signed in Rome on 25 March 1957. They came into force on 1 January 1958.

The United Kingdom proceeded with its idea of a FREE TRADE AREA and founded EFTA in 1960, together with Austria, Denmark, Norway, Portugal, Sweden and Switzerland. Soon, however, the British government reversed its position and decided to join the EEC. Its application was twice vetoed by French President Charles De Gaulle, in 1963 and again in 1967. The UK was finally able to join in 1973, together with Ireland and Denmark. Greece joined in 1981, followed by Spain and Portugal in 1986. The last enlargement took place in 1995 when Austria, Sweden and Finland were admitted. The Norwegian government twice negotiated entry and twice saw the treaty of accession rejected in national referenda (1973 and 1995). In 1967, the executives of the ECSC, EURATOM and the EEC were merged in what came to be known as the EUROPEAN COMMUNITY (EC). Following the 1992 MAASTRICHT TREATY, the EC has become the first, and most important pillar, of the new EUROPEAN UNION (EU).

From an economic point of view, the EEC can be regarded as a common market on the way to becoming an economic union. From a political point of view, it is an organization *sui generis* – more than a traditional international organization, but less than a federation. This unique character is reflected in its institutions, which combine intergovernmentalism with supranationalism.

The EUROPEAN COMMISSION can be seen as the European functional correspondent of a national cabinet. Its members are appointed by national governments but act independently once in office. Its major responsibilities are to propose and/or develop policies, draft legislative proposals and supervise the implementation of common policies.

The task of the Council of Ministers (renamed Council of the European Union in

European Economic Community (EEC)

1992) is to turn the commission's proposals into law. To this purpose, it is assisted by a Committee of Permanent Representatives. The members of the council are national cabinet ministers whose identity depends on the type of legislative proposals on the agenda. Although on important issues the council prefers to reach unanimity, decisions in some policy areas can be taken by qualified majority or simple majority.

The European Parliament (626 directly elected members since 1979) used to have only a consultative role. Following the SINGLE EUROPEAN ACT (SEA) and then the Maastricht Treaty, however, the parliament has acquired a more central role in the legislative process through the so-called 'co-operative' and 'co-decision procedure'. Next to its original power to dismiss the commission en masse through a motion of censure, it has also acquired the right to approve the appointment of the commission, as well as set up committees of enquiry. In 1999, following the report of one of these committees investigating alleged personal misconduct by some commissioners, the whole commission resigned without waiting for a motion of censure.

The European Court of Justice (composed of one judge from each member-state) ensures that Community law is respected and adjudicates disputes between citizens, member-states and EC institutions. Community law consists of *regulations* (binding, immediately and directly applicable in all member-states, and overriding national legislation), *directives* (binding for what concerns their objectives, but leaving to national governments the choice of policy instruments), *decisions* (binding, but applying only to the agents to which they are specifically directed) and *recommendations* (not binding).

The major objective of the EEC was the establishment of a COMMON MARKET. This required the gradual abolition of all barriers on trade between member-states, as well as convergence towards a common external tariff. TARIFFS were phased out by the end of the 1960s, but NON-TARIFF BARRIERS (NTBs) (in the form of a host of national health-and-

safety laws, regulations and practices) proved more difficult to remove. A major step in this direction was taken only in 1987, with the adoption of the Single European Act. The formation of a common market by states that are actively engaged in the management of their economies also demands the development of common economic and social policies, or at least the coordination and/or harmonization of their national policies, if one wants to assure 'fair' competition.

Thus, although the main policies explicitly provided for in the TREATY OF ROME concerned external commerce, agriculture and competition, the EEC has along the way acquired responsibilities in many other areas. This has been the result of factors such as the so-called SPILL-OVER effect, initiatives of the commission and, occasionally, the perception of national governments that it would be advantageous to shift some policies, wholly or partially, to the Community level. Explicit treaty provisions, on the other hand, have not been a guarantee of policy development. Thus a common transport policy was not seriously developed until the end of the 1980s. Likewise, although the treaty specified that national macro-economic policies should be 'a matter of common concern', member-states for a long time did not act as closely together as one could have expected. Even when they did, as in the case of exchange rate policies in the 1970s and early 1980s, such policy coordination took place outside the treaty. Only in the wake of the Single European Act, did the EEC make a formal move towards economic and monetary integration.

Whereas in federal systems the constitution provides for a more or less clear division of powers between the federal government and the governments of member-states, in the EEC there is no such clear-cut division. In some areas, the EEC has extensive policy involvement (external commerce, agriculture, fishing, market regulation, monetary). In others, such a competence is largely shared (basically all economic, regional and social policies). Finally, there are areas in which the involvement of the Community is still very limited (for example,

health and education). In the area of extensive involvement, the Community has at its disposal well-established legal and financial policy instruments. In the other areas, instead, the Community serves primarily as an arena for exchange of ideas and information and for policy coordination among member-states. Policy instruments in these cases are not very dissimilar from those available to traditional international organizations – that is, they are primarily exhortative and persuasive.

The EEC was originally financed by contributions from member-states and became fully self-financing only by 1980. EEC revenues (or ‘own resources’) come from four sources: agricultural levies on trade with non-member countries; custom duties; a percentage (originally 1 per cent, later increased to 1.4 per cent) of the **VALUE ADDED TAX (VAT)** collected in member-states, and a transfer from member-states based on their **GROSS NATIONAL PRODUCT (GNP)**. Two items dominate expenditures: the **CAP** (or, more precisely, agricultural price support) and structural policies (pursued mainly through the **European Regional Development Fund**, the **European Social Fund** and the **Cohesion Fund**).

Enlargement to include new central and eastern European democracies, reform of EEC institutions and reform of the **CAP** are three issues likely to be high on the EEC agenda during the next decade. In the longer run, the institutional mechanisms of the EEC might be extended to cover decision-making in what are now pillars two and three of the European Union (see **EUROPEAN UNION (EU)** for further details).

OSVALDO CROCI

European Free Trade Association (EFTA)

The European Free Trade Association (EFTA) was established in 1959 as a rival body to the then European Economic Community (EEC) by a grouping of West European states under

the leadership of the United Kingdom. The United Kingdom had considered the EEC to be too ambitious. Moreover, it considered that a successful EEC would require too great a sacrifice of national **SOVEREIGNTY**. EFTA was thus intended to provide the benefits of **FREE TRADE** in terms of **ECONOMIC GROWTH**, but was markedly different from the EEC in that it sought no significant economic **INTEGRATION** and certainly no flanking measures like the **COMMON AGRICULTURAL POLICY (CAP)**.

Western Europe was thus divided into two economic spheres: the ‘inner six’ of the EEC and the ‘outer seven’ of EFTA (at the inception, the United Kingdom, Austria, Denmark, Norway, Portugal, Sweden and Switzerland). The EEC refused to develop formal ties with EFTA, concentrating instead on the economic development which eventually undermined UK resistance to EEC membership. On the accession of the United Kingdom to the EEC in 1973, EFTA was rendered partially obsolete, continuing as a means by which neutral countries, small states and those like Austria that were dependent on goodwill from the then **USSR** could enhance their trade flows. Countries seeking rehabilitation in the European mainstream on their emergence from dictatorship (Greece, Spain) thus opted to join the **EUROPEAN UNION (EU)** instead of EFTA. With the end of the **COLD WAR**, EFTA was further weakened by the accession in 1995 of Austria, Finland and Sweden to the EU, an action prompted by those states’ desire to influence the single European market and currency. EFTA continues as a rump organization, comprising Norway and Switzerland (both of which having rejected EU membership), Liechtenstein and Iceland.

See also:

European Economic Area (EEA); European Economic Community (EEC); European Union, eastern enlargement of the

ALEX WARLEIGH

European Investment Bank (EIB)

The European Investment Bank (EIB) was established in 1958 under the TREATY OF ROME (1957), as one financial arm of the EUROPEAN ECONOMIC COMMUNITY (EEC) designed to help promote European integration, cohesion and development. Unlike the fund linked to the COMMON AGRICULTURAL POLICY (CAP), it does not rely on funds contributed by member governments to the annual Community/Union budget. Instead, it has capital backing from the member governments to enable it to borrow large sums cheaply on the international financial markets and then lend them to governments and firms for long-term projects in less prosperous areas (in a similar way to the WORLD BANK). As well as making loans, it provides technical assistance and can offer loan guarantees. It is normal for the receiving governments/firms to contribute 50 per cent or more of the finance for these projects – that is, the EIB acts as catalyst in mobilizing funds. The EIB's loans are long-term and make available funds which most national governments would not be able to raise as cheaply, given the triple-A CREDIT RATING of the EIB. The EIB has supported the regional policy of the EUROPEAN UNION (EU), providing funds in addition to the EU money from the annual budget which goes through the Regional Fund and also, in the 1990s, the Cohesion Fund. Its loans have also enhanced EU aid policy, over and above loans and grants provided through the budget-funded European Development Fund (EDF). The EDF sometimes allocates funds to subsidize the interest rate on EIB loans. While loans to non-members are the exception, as many as 130 countries have been recipients with the majority of such loans in the 1990s going to East European countries (excluding Russia and the other CIS states) most of which were hoping to become members. The EUROPEAN BANK FOR RECONSTRUCTION AND DEVELOPMENT (EBRD) (begun in the early 1990s) coordinates its (much smaller) efforts with the EIB. The EU's Trans-European Networks (TENS) initiative to improve trans-

port and communications, and protect the environment, is another policy area to which the EIB has contributed. By the 1990s, the scale of lending and borrowing by the EIB surpassed that of the World Bank. At the end of 1996, outstanding loans amounted to €130 billion and, during 1996, the EIB raised €18.6 billion in twenty-two currencies. For such a major public institution, it has a high degree of autonomy with very limited democratic accountability: a cause of concern within the European Parliament.

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DAVID LAW

EUROPEAN MONETARY INSTITUTE (EMI) see European Central Bank (ECB)

European Monetary System (EMS)

The European Monetary System (EMS) was adopted by the EUROPEAN COMMUNITY (EC) governments in Brussels in December 1978, with the goal of stabilizing monetary and EXCHANGE RATE relations within the European common market. Politically orchestrated by German Chancellor Helmut Schmidt and French President Valéry Giscard d'Estaing, the EMS was meant to deepen EC cooperation on monetary affairs after the breakdown of the BRETTON WOODS SYSTEM and an earlier aborted effort at a European solution to the withdrawal of the United States from leadership of the international monetary regime.

The EMS set up the framework for such cooperation by establishing a new **FIXED EXCHANGE RATE** regime, called the **EXCHANGE RATE MECHANISM (ERM)**, which came into operation in March 1979 with an agreement signed by the EC's central banks. The European Currency Unit (ECU) was created to serve as the centre of the ERM, although in practice it largely served as a simple unit of account. The EMS agreement included provisions for the financing, within the already existing European Monetary Cooperation Fund, of currency interventions on the part of states whose exchange rates drifted out of the ERM assigned bands. Finally, the EMS called for a more institutionalized pooling of monetary resources, the European Monetary Fund (EMF), but the EMF was never established due to disputes among the member-states over its functions and mandate.

All of the then members of the EC joined the EMS at its creation: Belgium, Denmark, France, Ireland, Italy, Luxembourg, the Netherlands, the United Kingdom and West Germany, but the UK has not participated in the ERM except for the period 1990–2 and Italy left the ERM from 1992–6. The three countries that joined the EC in the 1980s – Greece (1981), Spain and Portugal (1986) – became immediate members of the EMS but not the ERM (the latter two subsequently joined, however). Austria, Sweden and Finland all joined the EMS when they acceded to the EUROPEAN UNION (EU) in 1996; only Sweden did not also join the ERM.

Despite being inaugurated under a cloud of almost universal scepticism, the EMS has proven remarkably resilient at providing monetary stability. However, it has never become a full-fledged institution, but has instead functioned more as a loose agreement among the central banks of the EC states. In 1999, the EMS was replaced, for the majority of member-states, by **ECONOMIC AND MONETARY UNION (EMU)**, with its European Central Bank (ECB) and single currency, the euro.

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KATHLEEN R. MCNAMARA

European Payments Union (EPU)

The European Payments Union (EPU) was created to facilitate intra-European trade following World War II and to assist western European states in meeting their obligations under the charter of the **INTERNATIONAL MONETARY FUND (IMF)** to liberalize the convertibility of their currencies. While the IMF charter generally forbade discriminatory currency practices or exchange-control regulation on current account transactions, temporary

European Technical Standards Institute (ETSI)

exceptions had been granted to European states and Japan under the terms of Article XIV. Western European governments were generally hopeful that the new international monetary order would stabilize their economies and permit a rapid transition to full currency convertibility; however, as events developed, these hopes proved ill-founded. Full recovery ultimately required several years and the stability of European currencies against the dollar during this period ultimately depended on the infusion of considerably more American aid.

The economic crises of 1947 and 1949, in conjunction with the emerging dynamics of the COLD WAR, persuaded Western authorities to develop a European institution capable of facilitating the transition of European currencies to full convertibility. The EPU was formed in July 1950 towards this end, the successor of a series of less robust arrangements. The mechanism adopted within the EPU for settlement of each country's net position against its partners was based on a compromise between the interests of net creditors within the system (who preferred to be compensated in gold or dollars) and net debtors (who wished to be extended credit). The resulting arrangement did not result in large net liabilities for the EPU because, fortuitously, the participating states ran a net payments surplus with the United States beginning in 1950. As a consequence, the institution's working capital (largely provided by the United States) proved sufficient to cover the minor and temporary imbalances which did occur.

The EPU was disbanded in December 1958 when its members made their currencies fully convertible. During its tenure, the institution had functioned both as an adjunct to the early BRETTON WOODS SYSTEM and as a transforming agent of the day-to-day workings of that system. It also helped establish important precedents for intra-European monetary co-operation that proved helpful in establishing the European currency 'snake' in 1972 and later the EUROPEAN MONETARY SYSTEM (EMS) in 1979.

See also:

balance of payments; capital, controls on; European Economic Community (EEC); exchange controls

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DAVID M. ANDREWS

EUROPEAN RECOVERY PROGRAM (ERP) *see* Marshall Plan

European Technical Standards Institute (ETSI)

The European Technical Standards Institute (ETSI) is a non-profitmaking organization created in 1988 by the EUROPEAN COMMISSION to carry on the work (formerly performed by the European Conference of Postal and Telecommunications Administrations) of establish-

ing telecommunications standards, especially European Technical Standards. Some of its standards are adopted by the Commission as the technical basis for directives or regulations. ETSI's standards are voluntary, but they are established by those members who implement them. In practice, therefore, its deliberations are authoritative, regardless of whether they are formally incorporated into Commission documents or not. ETSI comprises a secretariat, a general assembly, a board and a technical organization. The last of these is that which produces and approves technical standards.

ROBERT M. CUTLER

European Union (EU)

The European Union (EU) was established by the Treaty on European Union (TEU, better known as the MAASTRICHT TREATY), signed on 7 February 1992, and entered into force on 1 November 1993. This treaty brought together, in a structure commonly represented as a Greek temple with three pillars: the EUROPEAN COMMUNITY (EC), the European Political Cooperation procedure – renamed COMMON FOREIGN AND SECURITY POLICY (CFSP) – and a more recently developed area of cooperation known as the Trevi Process – relabelled Justice and Home Affairs (JHA). At its inception, the EU included twelve countries: Belgium, France, Germany, Italy, Luxembourg and the Netherlands (founding members of the EC) and Denmark, Ireland and the United Kingdom (all of which joined the EC in 1973), Greece (1981), and Portugal and Spain (1986). Austria, Sweden and Finland joined the EU in 1995.

The EU is the outcome of an attempt to arrange in a single structure all the institutions and cooperative procedures that the process of European INTEGRATION has created since the early 1950s. This makes its categorization difficult. From an economic point of view, it can be defined as a COMMON MARKET with some elements at least of an economic union. In this respect, it represents the most developed example of a trend within the global economy

toward the formation of larger and more integrated markets. In addition, however, the EU has a political dimension, exhibiting a unique mixture of intergovernmental and supranational features, which makes it more than an international organization but less than a federation (see INTERNATIONAL ORGANIZATIONS (IOs)). This political 'over-development' cannot be explained solely by the fact that European states have a more rooted tradition of intervention in the market. Rather, it has arisen because the process of European integration has been a complex, multidimensional process, pushed forward by different actors (individuals, groups and governments) having different interests regarding integration and different visions of what integration was supposed to achieve. Some actors have undoubtedly looked at it primarily as an economic venture that should not erode the political sovereignty of member-states. Others, however, have regarded it as a process leading to federation. These contradictory perspectives are reflected in the academic literature. Neo-functional theory expects the process of integration to result in a vaguely defined 'new political community'. The international political economy (IPE) literature, on the other hand, tends to regard the EU as an advanced example of regional GOVERNANCE – that is, cooperative processes in which states engage in order to compete more effectively in the world market and cope better with the external constraints of GLOBALIZATION.

The EU is presided over by the European Council, a meeting of the heads of state or government of the member-states. The meetings of the European Council, a regular occurrence since 1974, used to take place outside the legal framework of the EC treaties. Their main objective, however, was to provide direction to, and often break deadlocks within, the EC. By establishing that the 'European Council shall provide the Union with the necessary impetus for its development and shall define the general political guidelines thereof', the TEU has simply given a legal basis to a consolidated practice.

The genesis of the EU

After the period of so-called 'Eurosclerosis', the process of European integration was revived in 1986 through the SINGLE EUROPEAN ACT (SEA), which aimed at completing the common market by removing many of the existing NON-TARIFF BARRIERS (NTBs). The new dynamism provided by this initiative enabled the EC to put again on its agenda some long-standing issues that had fallen by the wayside. First, there was the project of ECONOMIC AND MONETARY UNION (EMU), which at this point came to be perceived as the logical next step for the completion of the single market. Second, there was a call on the part of some member-states for greater EC involvement in social policies to counter-balance the liberal, pro-market character of the SEA, avoid the danger of social dumping and assure fair competition.

These internal factors were compounded by external ones, such as the 1989 revolutions in Eastern Europe, the subsequent collapse of the Soviet Union itself and the reunification of Germany in 1990. These events convinced many that the EC had to give itself an institutional structure that would enable it to respond effectively to the rapidly transforming European environment. The reunification of Germany, in particular, led some member-states to regard reinforcement of EC institutions as the best way to avoid the danger of German domination. Between 1988 and 1990, the European Council commissioned two studies on the feasibility of EMU and political union, and then convened two Intergovernmental Conferences (IGCs) to work out more detailed plans. The IGCs worked throughout 1991, trying to bridge the usual divisions between member-states favouring a more supranational structure and those preferring an intergovernmental one. They presented their report to the December 1991 meeting of the European Council at Maastricht. More difficult negotiations and some last minute compromises eventually yielded the three-pillar structure of the EU.

The three pillars: (1) The European Community (EC)

The EC forms the first pillar of the EU. The main role of the EC continues to be the advancement and management of the common market. This requires efforts towards both negative and positive integration. Negative integration refers to the removal of all tariff and non-tariff barriers to the free circulation of goods, people, services and capital. This task, although not yet complete, made a great leap forward with the implementation of the SEA. Positive integration demands, at least in a context where states are actively engaged in market-regulating activities, the development of common economic and social policies or, at a minimum, the coordination and harmonization of the policies of member-states. This is an ongoing task.

What distinguishes the EC from the other two pillars is that decisions in its areas of competence are taken through institutions having, at least partly, a supranational character. The EUROPEAN COMMISSION (currently formed by twenty members appointed by the governments of member-states, but acting independently once in office) is the hub of the EC institutional machinery. It initiates legislation, implements common policies (albeit mainly by relying on the civil service of member-states) and acts as guardian of the treaties. The COUNCIL OF THE EUROPEAN UNION (formerly known as the Council of Ministers and hereafter referred to as the Council) is the institution representing member-states. Its main role is to turn the Commission's proposals into EC law. This takes the form of *regulations* (binding and directly applicable in all member-states), *directives* (binding as to their goals, but leaving national authorities the choice of means for their implementation), *decisions* (binding, but applicable only to the member-state, firm or individual to which they are addressed), and *recommendations* and *opinions*. Voting in the Council can take place by simple majority, qualified majority or unanimity. The choice

depends on what the treaties prescribe concerning the issues on the agenda. The TEU, however, has sought to extend the use of qualified majority vote. Although most often composed by ministers of foreign affairs, the composition of the Council changes depending on the policy area in which decisions have to be taken. The European Parliament (626 members directly elected since 1979) is the least developed of EC institutions. It plays a merely consultative role. The TEU has increased the Parliament's role in the legislative process through the introduction of the co-decision procedure, which puts the Parliament almost at a par with the Council. It has also acquired the right to approve the appointment of the Commission, as well as set up committees of inquiry and appoint an ombudsman. The Court of Justice (composed of one judge from each member-state) ensures that treaties and Community law are respected and adjudicates disputes between citizens, member-states and EC institutions.

The TEU has added economic and monetary union to the objectives of the EC. Economic union implies enlarging the scope of common economic policies, since mere coordination might not be sufficient once a common monetary policy is in place. Monetary union is not a new project. Indeed, the EC began operating with at least one main component of a monetary union, namely fixed exchange rates, by virtue of its being part of the BRETTON WOODS SYSTEM. When this system began to collapse in the late 1960s, it became evident that exchange rate fluctuations posed a problem for what was becoming a progressively more integrated market. They proved particularly disruptive for the administration of the COMMON AGRICULTURAL POLICY (CAP). Thus, at the 1969 Hague meeting of the European Council, the idea of a monetary union was first put forward. In the end, the EC was only able to adopt more modest schemes that aimed at limiting the range of exchange rate fluctuations. The first, launched in 1972, was the so-called 'snake'. By the end of 1973, however, it had been reduced to nothing more than a limited German Deutschmark zone. The

second, set up in 1979, was the EUROPEAN MONETARY SYSTEM (EMS). This proved more successful, although some currencies were repeatedly obliged to leave it and then devalue before rejoining.

The EMU has adopted a three-stage approach. In Stage 1, all member-states were supposed to join the EXCHANGE RATE MECHANISM (ERM), a component of the EMS designed to keep European currencies within a narrow band of fluctuations. Stage 2 began on 1 January 1994 with the setting up in Frankfurt of the European Monetary Institute (EMI), forerunner of a full-fledged European Central Bank that will eventually acquire full control over monetary policies. Stage 3, set for 1 January 1999, saw the irrevocable fixing of exchange rates and the subsequent adoption of a common currency known as the euro. Taking a middle ground between the positions of the 'monetarists' (who advocate an immediate move to fixed exchange rates) and the 'economists' (who claim that a period of adjustment is necessary), the EMU specifies that in order for member-states to participate in Stage 3, they will have to meet, or at least come close to meeting, a set of five convergence criteria concerning inflation levels, interest rates, deficits, debt and currency stability.

Finally, the TEU has introduced the much-talked-about 'principle of subsidiarity'. This requires that in areas not falling within the exclusive competence of the EC, policy decisions be taken at the lowest possible level. Although the introduction of this principle is regarded as a victory for those resisting supranational integration, it could conceivably also be used to strengthen the argument for taking some decisions at the Community level.

The three pillars: (2) The Common Foreign and Security Policy (CFSP)

The second pillar of the EU is formed by procedures known as the Common Foreign and Security Policy (CFSP). Whereas external relations (which in 'Eurojargon' mean mainly commercial policy) fell within the provisions of the EUROPEAN ECONOMIC COMMUNITY (EEC)

treaty and have therefore been an EC responsibility since its inception, foreign and defence policies remained under the control of member-states. Ironically, the attempt to develop a common foreign and defence policy predates the formation of the EEC, since it goes back to the failed projects of setting up European Defence and Political Communities in the early 1950s. In 1961, French President De Gaulle put the issue on the EC agenda again through the Fouchet Plan. Because it appeared to be an attempt to turn the EC in an intergovernmental direction, the plan was rejected by the other member-states. Concrete steps to coordinate foreign policy began after the 1969 Hague meeting of the European Council, which established regular discussions between foreign ministers. This practice, known as European Political Cooperation (EPC) remained outside the EC treaties (although the President of the Commission was eventually included in the meetings) until the signing of the TEU.

The major purpose of the CFSP is to promote the identity of the EU on the world scene. To this end, the Council may adopt 'common positions' and decide on 'joint actions'. The most innovative aspect of CFSP is the explicit inclusion of 'all questions relating to the security of the Union, including the eventual framing of a common defence policy, which might in time lead to a common defence'. To this purpose, the TEU has resurrected the Western European Union (a military alliance formed in 1948) and made it the embryonic defence arm of the EU by charging it with the task of elaborating and implementing any actions with defence implications. This task, however, is carried out outside the framework of the CFSP. Moreover, differences of opinion remain concerning the relationship that any EU defence arrangement should have with NATO.

The three pillars: (3) Justice and Home Affairs (JHA)

The third pillar of the EU is formed by cooperation in the field of justice and home affairs. The genesis of this pillar goes back to

the mid-1970s, when justice and interior ministers of EC member-states began to have periodic meetings to discuss matters related to terrorism, drugs and organized crime. As in the case of EPC, these activities developed outside the framework of the treaties and came to be known as the Trevi Process. With the completion of the single market and the progressive dismantling of border controls resulting from the Schengen Agreements, cooperation extended to new areas, most notably customs, immigration and asylum, police and law enforcement, and judicial matters. The TEU has basically systematized these areas of cooperation and incorporated them into the treaties. It is the responsibility of the Council (in the composition of interior and justice ministers) to take 'common positions' and decide on 'joint actions'.

Although the JHA pillar, like the CFSP, functions on an intergovernmental basis, they both share decision-making institutions with the EC. The TEU, in fact, has granted the Commission rights of initiative comparable to that of member-states in both pillars and has abolished any distinction between the Council and meetings of national ministers in the framework of the CFSP and JHA (which is why the EC Council of Ministers has been renamed Council of the European Union). The Council, moreover, might decide by unanimity that measures implementing 'joint actions' are to be adopted by a qualified majority. Finally, the Parliament receives regular reports on the activities of both pillars from the Commission and the Presidency of the Council, and must be consulted on the most important aspects of such activities.

The opting-out clauses

One final, important feature of the TEU are its 'opting-out clauses'. During the negotiations, the British government was very reluctant to grant additional responsibilities to the Community in the field of social policy. In 1989, it had refused to sign the Social Charter, which the Commission had drawn up in an attempt to give a 'social dimension' to the single market.

Now, it opposed the action programme (a proposal for directives drawn up by the Commission for approval by the Council) that was needed to implement the provisions of the Social Charter. The resulting compromise was to add to the TEU a separate Social Chapter which would not apply to the United Kingdom, but would enable the remaining members to proceed with the action programme.

Other opting-out clauses allow the United Kingdom and Denmark to decide if and when they will join Stage 3 of monetary union. Denmark, moreover, has opted out of deliberations and actions under the CFSP which have defence implications. These opting-out clauses could be taken as an indication that the idea of a multi-speed, multi-tier Europe is gaining some ground. Flexibility and compromise, however, are part of the history of European integration and have been a key to its constant, if slow, advance. The United Kingdom and Denmark will, most likely, eventually rejoin the group in these areas.

The way ahead

The fact that ratification of the TEU encountered some difficulties, especially in France and Denmark, was taken as a sign that the enthusiasm of governments for extending integration was perhaps running ahead of popular opinion. As a consequence, the relationship between the general public and the EU became one of the main areas of discussion at the 1996 IGC, convened to review all the procedures and policies introduced by the TEU. The resulting Treaty of Amsterdam, signed on 2 October 1997, has therefore put much emphasis on employment (shown by public opinion polls as the principal concern of Europeans), as well as citizens' rights. The promotion of employment has now become one of the explicit objectives of the EC and the coordination of national employment strategies has been added to its responsibilities. The TEU had already created the concept of Union citizenship – granting the citizens of any member-state the right to live and work anywhere within the EU, to vote and stand as

candidates in European and local elections in their place of residence, and to be protected outside the EU by the diplomatic authorities of any member-state. The Treaty of Amsterdam has added provisions aimed at furthering the respect for fundamental rights, both on the part of EU institutions and within member-states, making EU procedures more transparent and facilitating citizens' access to EU information. Finally, the new treaty attempted to increase the use of qualified majority voting in the CFSP pillar and to transfer all matters relating to the movement of persons from the third to the first pillar. Had the treaty been ratified in its original form, the JHA pillar would have been reserved mainly for matters relating to police and criminal law.

The most pressing items on the EU agenda at the end of the century were, internally, the completion of EMU and, externally, enlargement to include the new Central and East European democracies (see EUROPEAN UNION, EASTERN ENLARGEMENT OF THE). The issue of enlargement is, in turn, inextricably linked to two other perennial issues, namely institutional deepening and reform of the CAP. Two general predictions concerning the future of the EU can be made with a relatively high degree of confidence: first, it will continue to evolve according to the precarious equilibria resulting from a balancing act between the heritage of national histories and the need to respond to challenges that transcend national borders; second, regardless of the precise content of this evolution, it will remain the key institution of European governance.

Further reading

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the EU, including EC institutions and policies.

OSVALDO CROCI

European Union, eastern enlargement of the

According to Article 237 of the TREATY OF ROME and Article O of the MAASTRICHT TREATY any European state may apply to become a member of the EUROPEAN UNION (EU). In addition to the legally sufficient condition for membership, there are several other necessary economic and political requirements for entry. They were formally defined during the 1993 EU Copenhagen Summit. The potential candidate country must fulfil three conditions. It must (1) have a functioning market economy; (2) have a stable democratic political system; and (3) accept, implement and enforce the *ACQUIS COMMUNAUTAIRE*. The fourth (tacit) requirement is that the enlargement should not imperil the EU's financial resources, nor should widening of the EU endanger the deepening of the integration process. These entry conditions reveal that the EU has considerable discretionary power and flexibility in selecting the would-be members. Those rights were used when the EU started enlargement negotiations in 1998 with five transition economies (the Czech Republic, Estonia, Hungary, Poland and Slovenia) and with Cyprus, a small but relatively developed market economy. Other selected transition economies (Bulgaria, Latvia, Lithuania, Romania and Slovakia) and one market economy (Malta) started enlargement negotiations with the EU in 2000. In order to facilitate and operationalize the enlargement process in the medium term, the EU published its medium-term plan *AGENDA 2000* in 1997.

Together the acceding twelve countries (ten countries with economies in transition plus two market economies – 10 + 2) would bring over 106 million additional consumers into the EU. However, some of these countries are so small

that the EU economy would hardly notice their entry. The candidate transition economies have, on average, a significantly lower (around one third) GROSS DOMESTIC PRODUCT (GDP) per capita than the EU average and two to three times higher relative contribution of agriculture to the GDP than is the case with the EU (2.4 per cent in 1998). While the average share of agriculture in total employment in the EU was 5.3 per cent (1998), in the acceding transition countries the share was more than twice as much (in Poland and Romania, it was 25 and 38 per cent respectively). With such an economic structure, the acceding transition countries would be eligible for large regional and agricultural funds from the EU. This is particularly relevant for Poland because of its large population (39 million) and relative 'backwardness' measured by the GDP per capita.

Transition economies share political, security and economic reasons for joining the EU. Politically, the transition countries have a still young and relatively fragile democratic system. Fragility comes from the grand hopes – unfulfilled for over a decade – that change towards a market-type democratic system can take place in a relatively short period of time and at a relatively modest cost. Regarding security, although armed conflict between the East and the West is no longer an immediate threat, there is still an apprehension regarding the division of 'spheres of influence' between the West (the EU and, principally, Germany) and Russia. The Central, East European and Baltic states obtained their freedom from the 'Eastern bloc'. They have concerns both about preserving their independence and about 'losing' that independence to the West. As for the economic issues, there are gains and costs for the acceding countries from entry into the EU. The major benefit for the 10 + 2 countries would be secure access to the huge market of the EU. This is particularly relevant for the goods that are 'sensitive' for the EU (farm products, textile, steel, chemicals) as the 10 + 2 countries have COMPARATIVE ADVANTAGE in the production of those goods. Entry would mean a kind of 'insurance policy' that the EU

trade regime would remain open to their exports. The second gain would be the possibility of the migration of labour into the rest of the EU following a specified adjustment period. This may, however, have a two-edged effect. If the educated and the experienced leave the transition countries, productivity in the 'transition region' would suffer and funds for the education of experts would be lost. A relatively tight labour market in the rest of the EU(15) would prevent such a scenario. A third benefit from entry comprises access to EU structural and other funds.

None of these gains are without risk. In some cases, these costs are quite heavy. Transition countries still have fragile economies that would be exposed to fierce competition in the Single European Market (SEM). Adjustment troubles are well known, even in the relatively advanced transition economy of East Germany after the Anschluss of 1989. Net annual transfers from the western part of the reunified Germany to the eastern part were around DM150 billion throughout the 1990s and they will continue for some years in the future. If the relatively advanced East Germany needed such massive transfers, the potential transfers to other acceding transition countries are a major concern. Thus the question for acceding transition countries becomes whether they are perhaps aspiring to do too much too soon. It is difficult to predict where funds to accommodate the transition countries could come from. The Maastricht criteria for ECONOMIC AND MONETARY UNION (EMU) are requiring budgetary cuts throughout the EU. The 1995 Cannes Summit allocated 'only' €6.7 billion to the PHARE Programme for the period 1995-9; for the period 2000-06, *Agenda 2000* earmarked €45 billion as the pre-accession aid to the acceding countries.

Application, implementation and enforcement of the continuously evolving *acquis communautaire* is costly not only for the new members, but also for the countries that are already in the EU. Being less developed, the transition countries have both a lower financial capacity and a greater need to incorporate the EU rules. It is estimated that the implementa-

tion of the environmental dimension of the *acquis* (water, air and waste standards for the EU) in the five acceding transition economies that started negotiations in 1998 would cost as much as €120 billion. The EU will offer certain funds to these countries to ease the financial burden of meeting the entry criteria, but most of the funds will have to come from the acceding countries themselves. Can these costs be compensated for by the potential benefits that would come from entry? How long would it take? Is such an investment justified at the moment? Public opinion polls in transition countries rank care for the environment much lower than healthcare, education, security and the economy.

EMU is a part of the *acquis* for the acceding countries. If these countries were outside the EMU, their currencies might become the target for speculative attacks on the currency market that the country would be unable to withstand; they might then need to alter the rate of exchange and, by doing so, jeopardize trade flows and free competition in the SEM. Hence the need for the acceding countries to join the EMU. The four EU member-countries that were outside the EMU – Denmark, Sweden and the United Kingdom by choice and Greece by ineligibility (it satisfied the EMU conditions and joined the system in 2001) – should not be taken as precedents for the acceding countries. These four were already EU members when the Maastricht Treaty was negotiated and the EU has no declared intention to enlarge the non-EMU tier. Apart from inflation and exchange rate stability criteria, most of the acceding transition economies easily satisfy the other EMU criteria.

Farm gate prices of agricultural commodities in the acceding transition economies were on average within a range of 40 to 80 per cent of the EU level. If the COMMON AGRICULTURAL POLICY (CAP) is directly applied to the acceding countries, that would give a big boost to production in those countries and increase already high levels of EU self-sufficiency in most agricultural products. Hence the CAP needs to be changed prior to eastern enlargement.

Even though the economies of the acceding transition countries have been formally privatized to a large extent, they still do not operate in the way that is expected in a true market economy. They still lack good corporate governance. Such 'behaviour' cannot be introduced by decree. It is the product of gradual evolution.

The EU is generally interested in enlargement for various political, security, ecological and economic reasons. What the 10 + 2 countries would specially contribute to the EU's economy, however, is less easy to discern. Is the 'eastern' market – with its cheap labour and possibilities for investment – an opportunity or a threat? It should be remembered that European integration started in the early 1950s not for economic reasons, but rather for the preservation of peace. The political goal was to make war between Germany and France impossible through economic means. The southern enlargements of the EU, although costly in financial terms, had the objective of stabilizing democracy in Greece, Spain and Portugal following periods of dictatorship. Identical arguments can be used regarding the potential eastern enlargement of the EU. As for Cyprus, some goals may be reunification of the country and a reduction in tension in the east Mediterranean region. Stability and predictability at the eastern border is in the interest of the EU. Ecological and certain economic factors also apply. In addition, modernization of the transition economies may create and keep certain high-technology jobs in manufacturing and services within the EU.

The potential economic and political gains for the EU need to be seen alongside at least two economic costs. The first is the need to finance the adjustment of the acceding countries to the *acquis* and to the Maastricht criteria for EMU. This demands serious austerity measures. The question is where funds to help the 'east' would come from. The EMU member-countries are already making unprecedented budgetary cuts because of the requirements of this monetary system. Because of their own domestic problems and needs, many of the EU member-countries are un-

willing in this situation to expand EU funds to assist the acceding countries. The second cost could come from the (potential) loss of jobs and business in the 'sensitive' manufacturing industries and in agriculture within the EU. The fear is of an excessive penetration of goods from the east.

When the EU last accepted 'poor countries' (Spain and Portugal in 1986), the EUROPEAN COMMUNITY (EC), as it was then called, was not a single market for goods, services, capital and labour. In 1999, the EU deepened integration and became an EMU. The *acquis* will be very different in the year 2010 from what it was in 2001. Even though Spain and Portugal were 'poor countries', they were market economies. With this in mind, the opportunity for the accession of even the most advanced transition countries seems remote for quite some time in the future, unless and until the entry rules change or the economic situation in the acceding transition countries improves. The EU has few incentives and limited funds to accept countries with economic structures that are significantly different from those in the EU. Such an attitude may seem hypocritical given that the West has spent almost half a century encouraging those countries to join the free market and democratic world. Applicant countries need to exercise patience. An 'optimistic' prediction if 'all goes well' (meaning smooth negotiations of perhaps a decade and an adjustment process of another decade) would be that it may take the most advanced transition countries well into the second decade of the third millennium to become full members of the EU. Equally, while the entry of Cyprus would not create economic problems for the EU, the continuing Turkish occupation of the northern part of Cyprus will continue to cause political problems.

Consideration of the issue of timing and the terms of the new enlargement of the EU is highly speculative. The entry depends on the political will (and the funds) of EU countries, as well as on the adjustment process in the acceding countries. However, even when the funds and the political will existed for Spain and Portugal to negotiate entry into the EU,

their entry took several years more than expected and almost an additional decade to get up to full speed with the rest of the EU.

A continuing priority for the EU is the protection of the SEM. EMU was the EU's project for the 1990s and for several years beyond that. Reform of the CAP, regional and other policies are primary aims for the period after the turn of the millennium. Only once this is achieved, can the eastern enlargement of the EU take place.

European integration has always been based on the political decision to secure peace and liberty in Europe. That is the purpose of the EU, although this objective is frequently forgotten. Integration is intended to mitigate the impact of old rivalries and replace them with mutual economic advantage and social prosperity. Future enlargement would not bring the EU extra efficiency or growth or new technology; neither would it create new jobs. Its basic objective would be to give support to friendly countries and governments in their reform and general stabilization process.

MIROSLAV N. JOVANOVIĆ

evolutionary economics

The term 'evolutionary economics' is currently applied to a confusingly wide variety of approaches within the subject. At least six main uses of the phrase can be identified:

- 1 More than a century ago, THORSTEIN VEBLEN (1898) argued for an 'evolutionary' and 'post-Darwinian' economics. Institutionalists in the tradition of Veblen and John Commons frequently describe their approach as 'evolutionary economics', often using the terms 'institutional' and 'evolutionary' as virtual synonyms, as exemplified by the very names of the Association for Evolutionary Economics – the US-based association of institutional economists – and the European Association for Evolutionary Political Economy.
- 2 JOSEPH SCHUMPETER (1942) famously described capitalist development as an 'evolutionary process'. Work influenced by Schumpeter is also described as 'evolutionary economics', as evidenced by the title of the *Journal of Evolutionary Economics*, published by the International Joseph Schumpeter Association.
- 3 The approach of the AUSTRIAN SCHOOL of economists is often described as 'evolutionary', as portrayed in Carl Menger's theory of the evolution of money and other institutions, and by the extensive use of an evolutionary metaphor from biology in the later works of FRIEDRICH VON HAYEK, especially in relation to the concept of spontaneous order.
- 4 In addition, the economics of assorted writers such as ADAM SMITH, KARL MARX, Alfred Marshall and others is also sometimes described as 'evolutionary' in character.
- 5 Evolutionary GAME THEORY is a prominent recent development in mathematical economics and has been inspired by related mathematical work in theoretical biology.
- 6 The word 'evolutionary' is sometimes attached to work in what is also described as 'complexity theory', such as developed by the Santa Fe Institute in the United States. This involves CHAOS THEORY, replicator dynamics, genetic algorithms, genetic programming and various types of computer simulation.

With such a divergence of uses, it is unlikely that there is a single, underlying and coherent message. Indeed, in recent years, the use of the word 'evolutionary' in economics seems very much to be a matter of fashion. Apart from the institutionalist and Schumpeterian fringes, the use of the word 'evolutionary' did not become widespread in economics until after the publication of Richard Nelson and Sidney Winter's classic work *An Evolutionary Theory of Economic Change* (1982).

In the social sciences, the term 'evolution' fell out of fashion in the early twentieth century. Following the 'Golden Age' of the

late nineteenth century, the period up to World War II has been described by Stephen Sanderson as the 'Dark Age' for evolutionism in social science: 'even the word "evolution" came to be uttered at serious risk to one's intellectual reputation' (1990: 2). Even Schumpeter accepted in 1912 that 'the evolutionary idea is now discredited in our field' (1934: 57).

The re-emergence of the word 'evolution' in economics was even later than in other social sciences, particularly anthropology, where the use of it became quite common in the 1960s. However, by the late 1980s, work in 'evolutionary economics' had been broadened and accelerated by the growth in both America and Europe of various institutional, Austrian and Schumpeterian approaches to economics. There have been notable and fruitful applications of these ideas, particularly in the sphere of technological change. Evolutionary economics has already established an impressive research programme and has had a major impact on economic policy, particularly in the areas of technology policy, corporate strategy and national systems of innovation.

Nevertheless, there is still no established consensus on what 'evolutionary economics' should mean. Many economists use the term while wrongly taking it for granted that a common and obvious meaning is implied. A curious aspect of 'evolutionary economics' is that many people use the term as if it required little further explanation and that everyone knows what it means. Furthermore, 'evolutionary economists' are often unaware of much of the intellectual history of this term.

It is a serious mistake to take the meaning of the concept of economic evolution for granted. It is important both to sort out the different meanings of the term and to consider carefully its conceptual history. This essay briefly addresses some key issues that should arguably be central to a rich and meaningful notion of economic evolution.

The significance and meaning of novelty

It has been argued elsewhere (Hodgson, 1993, 1999) that the recognition of variety, and an

emphasis on novelty and creativity as being essential to replenish that variety, should be a central theme of 'evolutionary economics'. Similarly, Ulrich Witt writes: 'for a proper notion of socioeconomic evolution, an appreciation of the crucial role of novelty, its emergence, and its dissemination, is indispensable' (1992: 3). Accordingly, Nicolai Foss (1994) argues forcefully for an ontological characterization of the divergence between evolutionary and neo-classical thinking in economics. He argues that evolutionary economics of the type developed by Dosi, Nelson, Winter, Witt and others is concerned with 'the transformation of already existing structures and the emergence and possible spread of novelties' (Foss, 1994: 21). Indeed, whereas evolutionary economics theorizes on the basis of a universe that is open (in the sense that the emergence of novelties is allowed), neo-classical economics addresses closed systems and suppresses novelty. In short, evolutionary and neo-classical economics start from very different ontological assumptions about the social world.

One major source of novelty is individual creativity and choice. Arguably, genuine creativity, real choices and willed changes of purpose mean that human action must contain an element of indeterminacy in the sense of an uncaused cause. To choose or to create means that our choice or our creation is undetermined: we could have acted otherwise. Accordingly, it has been argued (for example, Loasby, 1976: 9) that the neo-classical idea of behaviour programmed by fixed preference functions does not admit genuine choice. Similarly, other economists, such as Frank Knight (1921: 221), Ludwig Lachmann (1969: 93) and George Shackle (1972: 122, 1989: 51), have argued that real freedom of choice requires indeterminacy and action that is not totally programmed by prior stimuli.

However, the idea of an 'uncaused cause' does not have widespread appeal, with most physical and social scientists assuming that every event must have a prior cause. The 'uncaused cause' is such a weird concept that statements of it are confined to a handful of

fringe economists and other oddballs. However, in one sense it is little more than the rehabilitation of the Aristotelian notion of finalism: a concept of causality different from the commonplace 'efficient' or mechanical cause.

Modern mathematics, in the form of non-linear dynamics and chaos theory, also raises the possibility of the deconstruction of causality and additional questions about indeterminacy and the meaning of novelty. Chaos theory suggests that even if the world is deterministic we would have to treat it as if it were indeterministic and unpredictable. Even if novelty is caused, it may appear as entirely spontaneous and free. Thus the very distinction between determinacy and indeterminacy is undermined. We can never know for sure if any event is caused or uncaused, but chaos theory suggests that we have to treat non-linear systems as if they were indeterministic. The chaos literature blurs the boundary between randomness and determinism.

Endogenous and exogenous change

The issue of an uncaused cause bears upon the question of endogeneity and exogeneity. In his studies of economic development, Schumpeter repeatedly emphasized the sources of change from within. Likewise, Witt defines evolution as 'the transformation of a system over time through endogenously generated change' (Witt, 1991: 87, original emphasis removed). Similarly, Esben Sloth Andersen (1994: 1) regards an 'evolving' as a 'self-transforming' economic system. However, it is difficult to find a justification for this one-sided emphasis on endogenous change. In biology, neither individuals nor species nor even ecosystems are entirely 'self-transforming'. Evolution takes place within *open* systems involving *both* exogenous and endogenous change.

Notably, however, if the possibility of an uncaused cause is admitted then the concepts of exogeneity and endogeneity require refinement. The distinction between them is typically based on the source of determination. We ask whether the factor *causing* change is inside or

outside the system. But if some events are *uncaused* then the absence of such a prior cause cannot be classified as either exogeneity or endogeneity.

Chaos theory does not solve this particular problem. Even if chaos theory makes indeterminacy deterministic, it does so by undermining the possibility of a reductionist or full causal explanation and by instating the concept of emergence. A property can be said to be emergent if there is a sense by which it depends upon lower level elements in a system, but is not predictable in terms of those elements or reducible to them. Emergent properties are not capable of full, reductive explanation in terms of other elements. Hence the same problem of demarcation between the exogenous and the endogenous arises. Emergent properties could be described as endogenous, but they are not subject to a complete explanation in terms of endogenous factors.

Instead of the one-sided emphasis on endogenous change in evolutionary economics, it would be better if more use was made of the concept of an 'open system'. The distinction between an open and a closed system was first made by Ludwig von Bertalanffy in 1950. The term has been taken up and emphasized by institutional economists such as K. William Kapp (1976) and the realist philosopher Roy Bhaskar (1975, 1979). In particular, Bhaskar discusses the intrinsic and extrinsic conditions of closure. He argues that extrinsic closure is absent in socioeconomic systems because such systems interact with their environment. National economic systems use export and import, and even the world economic system extrudes waste and is dependent on energy flows from the sun. Intrinsic closure concerns human agents: even if the system was otherwise closed then outcomes would not be determinate because of the potential novelty of human agency. If human beings are more than automata, they are not merely programmed responders to external stimuli: their actions cannot always be predicted. For these two crucial reasons, socioeconomic systems are not closed.

The significance of novelty and creativity in

an evolutionary framework is that they are a major source of variety within evolving socio-economic systems (Andersen, 1994; Metcalfe, 1988; Nelson, 1991, 1994). By such novelties and innovations, variety is replenished. On-going variety means that a population of entities cannot be represented by a few distinct characteristics which represent their essence. Such 'typological essentialism' is rejected in favour of 'population thinking'. In population thinking, species are described in terms of a distribution of characteristics. Whereas in typological thinking novelty and variation are classificatory nuisances, in population thinking they are of supreme interest because it is precisely the variety of the system that provides fuel for the evolutionary process (Foss, 1994; Hodgson, 1993; Mayr, 1985).

The challenges of evolutionary thinking to modern mainstream economics

Such a style of evolutionary thinking poses a challenge both to the form and content of modern mainstream economics. Let us briefly consider the question of form first. Much recent work describing itself as 'evolutionary economics' makes extensive use of mathematics. Some contributors are enthusiastic about such mathematical developments, seeing this as a way of making evolutionary economics part of the mainstream. Arguably, however, mathematical modelling taken to its limits in economics would greatly constrain novelty. Even if chaotic systems can seemingly generate novelty, they are limited by their own formal assumptions. In such models the system needs to be defined by formal assumptions in finite dimensions that limit the possible results. Even a stochastic process constrains the variance and occupies a given parametric space.

By its nature, novelty defies the boundaries of formalism. To endogenize the novelty-creating process within a formal framework is always to limit greatly the set of possible novel outcomes. Thus it would appear that modelling within evolutionary economics founders when it reaches the emergence of novelty.

Let us now turn to the matter of content. It

is a commonplace conjecture that biology is likely to become the most influential natural science in the twenty-first century. Apart from mere fashion, there are strong methodological reasons why economists should take account of evolutionary ideas. Notably, in an attempt to ground economics on sociobiology, Gary Becker (1976) suggested a genetic determination of rational maximizing behaviour. Jack Hirshleifer (1977, 1978) and Gordon Tullock (1979) followed with similar arguments and with suggestions that maximizing behaviour was common to both humans and other organisms.

However, recent work in evolutionary psychology undermines this 'Chicago' approach (see CHICAGO SCHOOL). Crucially, this work suggests that global rationality is very unlikely to emerge through evolution. Leda Cosmides and John Tooby (1994) postulate that the mind is riddled with functionally specific circuits. This contrasts with what they described as the 'standard social science model', in which the mind harbours general cognitive processes that are 'context-independent', 'domain-general' or 'context-free' (such as 'reasoning', 'induction' and 'learning'). They showed that this abstract and generalist view of the mind is difficult to reconcile with modern evolutionary biology, giving experimental evidence to support their argument. This evidence shows that humans are generally poor at solving general, logical problems. However, when these problems are reformulated in terms of hypothetical social interactions, our ability to solve them increases markedly, despite the fact that the logical structure of the problem has not changed (Cosmides, 1989; Tooby and Cosmides, 1992). The evolution of rational behaviour itself has to be explained and modern science suggests that the principles of Darwinism provide the key.

It has been suggested by Frank Hahn (1991) that a forthcoming development will be the deconstruction of the rational actor that has long ruled economics. Optimizing activity will be recognized as no more than a special case of a larger set of possible modes of behaviour,

with all of them being required to render viable explanations of their origin and evolution.

Clearly, evolutionary economics is at a crucial stage in its history. Nearly two decades after Nelson and Winter's *An Evolutionary Theory of Economic Change* (1982) there is much development, mutation and variety within this species of economics. A hundred years ago, Veblen tackled the problem of explanation of origin and thus attempted to recast economics in a 'post-Darwinian' mould. A century later, the question in the title of his famous 1898 essay is still with us.

See also:

economic realism; institutionalism

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- to the study of long-range transformations in worldwide political arrangements. It rests on the twin premises that world politics is subject to evolutionary processes and that such processes might best be understood with the help of evolutionary theory.
- The field comprises two main subdivisions: theoretical and applied. The first concerns the selection and elaboration of concepts, and the construction and testing of models for the study of structural change in world politics. The second applies this understanding to producing an account of the evolution of world political arrangements of the past millennium in particular, and to predicting the outlines of such an evolution for the near future.
- Worldwide political arrangements are those stable patterns of human behaviour that are institutionalized at local, national, regional and, in particular, global levels of social organization. These include, for the past and present, regional and world empires, systems of city states, the nation-state system, alliances, global leadership, and regional and international organizations. Such political institutions will be distinguished from worldwide economic institutions (such as international trade regimes), from social structures and processes (such as democratization), and from cultural processes (such as those shaping world opinion).
- The spatial domain of this study is planetary, but it concerns the political organization of the human species wherever its members might ultimately be found. Its temporal domain primarily relates to global political processes of the last millennium, but it raises questions about the earliest roots of worldwide political arrangements and is also capable of being projected into the future.

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evolutionary world politics

Definition

The field of 'evolutionary world politics' concerns the application of evolutionary theory

Explaining change

The principal focus of this field is explanation of structural change in world politics. The basic question is how and why do worldwide political arrangements change in specified time periods (for example, how do the occupants of the position of global leadership change, and why)?

It means that the description of world political arrangements or processes as such is not the main concern here, even though excellent descriptions of international institutions and fine mappings of global political processes are indispensable tools of this analysis, and also one of its products.

It is among the premises of this analysis that world politics is a field marked by regularities that are amenable to explanation and prediction. This (scientific) premise is shared by many students of international relations (IR) and international political economy (IPE), but it does make plain the fact that the subject is neither chaotic nor anarchic in the everyday sense of these terms. It is, rather, a challenging field of inquiry sharing many characteristics with the other social sciences, but also marked by special problems all of its own.

The focus on explaining institutional change is meant to be narrow and restrictive. It is intended to bring inquiry to bear on a parsimonious set of questions that are worthwhile and also capable of being answered. It is not intended to resolve all the countless other questions that might be asked about world politics, historical or contemporary (for example: Why have the Balkans been the scene of much conflict? What should the policy of the European Union be towards China?), even though such questions will also have structural implications.

The basic (substantial) premise of this analysis, previously mentioned, is the evolutionary one: world politics is subject to evolutionary processes (that is, to social evolution). It proposes that the substantial changes that can be observed in the long-range operation of world politics are the result of evolutionary processes.

The fact of change is evident to all those who choose to engage in the thought experiment of comparing world political arrangements of, say, 1,000 or even 500 years ago with those of the year 2000. In the past millennium, the entire world system has grown in size and composition, and with it also world politics has changed in the form, content and complexity of its organization. That is also why the thesis of

the allegedly permanent, hence unchangeable, nature of international politics and its consequently unavoidable propensity to catastrophic warfare is unacceptable. But, if global institutions are indeed subject to change, then that process can either be random, and hence unfathomable, or else marked by patterns of regularity. The task for evolutionary world politics is to explore that second possibility, and that is where evolutionary theory finds its place.

Evolutionary theory for global politics

In the biological sciences, evolutionary theory – in the form of the modern Darwinian synthesis – is now nearly standard. It has drawn strength from the revolution in genetics and debates now centre on ways of refining and extending that synthesis, rather than on substituting for it. The social sciences do not command a comparable consensus nor a widely accepted body of thought for analysing problems of social evolution. Some social scientists, notably in economics, have explored the potential of evolutionary theory in handling *inter alia* innovation and long-term growth (see *EVOLUTIONARY ECONOMICS*). In IR and world politics, an early attempt to apply natural selection to international politics (Bagehot, 1993 [1869]) confused rather than clarified issues. The residue of late nineteenth-century social Darwinism (Hofstadter, 1955), compounded by twentieth-century disenchantment with the historical determinism of Marxist thought, still rankle. In contemporary IR theory debates, the realists and the neo-realists (see *NEO-REALISM*; *REALISM*) now employ the analogy between natural selection, inter-firm and inter-state competition as ways to highlight the 'struggle for survival' aspects of international life. Liberal scholars emphasize the possibility of change and even progress via cooperation and the design of international institutions. Elements of both schools can be effectively synthesized in an evolutionary theory.

Against this background, evolutionary world politics calls for an approach that draws

on the theoretical capital of more than a century of evolutionary thought, but that is also focused more sharply on the questions that can and need to be answered. This is not a model of biological determinism in the neo-Darwinian mode or sociobiology, for it does not posit a primary causal influence from genetic endowment or biological make-up to predispositions to certain types of human behaviour and institutional change. But neither does it preclude such causation in principle, if and when such can be demonstrated. It does use modern Darwinian theory and, in particular, central concepts (such as selection) in the first place in an analogical manner.

Biological theory classically explains the origin of species, and their interrelationships, with the concept of 'natural' selection; evolutionary theory for world politics centres on processes of 'social' selection, important instances of which include elections, party competition, open information systems, free markets and, in the past, global wars. Whereas 'natural' selection concerns primarily the forces of nature (such as climate, geography or other species), 'social' selection is a matter chiefly of social arrangements and institutions. Where 'natural' selection acts via genetic material and necessarily takes time to produce its effects, 'social' selection can be faster, involves cultural criteria and acts on clusters of human action embodied in policies and strategies. Despite such differences, much is to be gained from viewing 'social' selection as analogical to the 'natural' variety. Selection is a concept of considerable generality and analytical power that includes choice, and that generality suggests an underlying mechanism common to evolutionary processes, a consideration that might apply to every evolutionary mechanism.

Evolutionary paradigm

An evolutionary paradigm for global politics consists of the following propositions (Modelski, 1996):

- 1 The global political system is a population of strategies or policies (viewed as sets of instructions or programmes) for the management of global problems; innovative strategies become the vehicles of evolution. This makes it clear that at certain (specified) times NATION-STATES can be carriers of global policies, but that nation-states as such are not the basic units of this analysis.
- 2 Global politics forms a complex system that has a propensity to evolve and does so in specified conditions, those exhibiting high evolutionary potential. That is, evolutionary change is in the first place a property of regions, countries and/or sectors (active zones) where evolutionary potential is palpable; that is, where inter alia heterogeneity, openness and mobility might be found.
- 3 Accounting for world political evolution at several levels is a four-phased learning sequence (or algorithm) whose operators are variation, cooperation, selection and reinforcement. Each such social learning process has a distinct period, and that makes evolution proportional to time. The basic beat of change is the generational period of some twenty-five to thirty years; that is the replacement interval, the rate by which one generation replaces itself.
- 4 Global politics co-evolves with global economics, democratization and formation of world opinion.

Evolutionary processes

Given these propositions, world politics evolution might be observed to occur at three levels, each one of which raises issues of major import for students of world politics.

- 1 At the broadest, most inclusive (macro) level, there is world political evolution – a profound change at the level of basic institutions. In the modern era, in the millennium now past, it has brought rising complexity taking the form of political globalization: the eclipse of empires going hand-in-hand with the emergence of forms of worldwide INTERDEPENDENCE and a nation-state system.
- 2 At the intermediate level, there is global

organizational evolution: the rise of organizations of GLOBAL REACH at the political level, such as (in tandem with the fading of empires) the emergence of the world powers and their naval/alliance networks as the focus of global politics. More recently, there is the parallel formation of an increasing variety of INTERNATIONAL ORGANIZATIONS (IOs).

- 3 At the micro-level, as it were, there is global positional change, the process by which positions of global leadership are filled and vacated, also known as the LONG CYCLE of global politics, or the rise and fall of world powers.

Each of these three evolutionary levels might be thought of as undergoing self-similar, four-phased learning processes of successively shorter periods, such that the shorter ones nest within the longer ones. The four-generation long cycle of global leadership nests in, and thereby drives, one phase of global organizational evolution. Each four-phase period of the organizational process (that is, lasting some sixteen generations) is one phase of the world institutional process. An illustration will be presented in Table 2.

Applied evolutionary world politics

So much for the elements of the theory of this field. What are the essentials of 'applied' evolutionary world politics? Two sets of 'applications' might be mentioned: (1) mastering the evolution of past world politics, and (2) predicting the evolution of future world politics.

Mastering an evolutionary approach means making the historical experience of world politics accessible to IR students. Traditional teaching of that subject privileges 'the world today' and neglects the more remote sources of current developments, let alone providing an intellectually respectable explanation of the structure and evolution of worldwide political arrangements. For students of this subject, the traditional approach in effect relegates such topics to the 'dustbins of history'. An evolu-

tionary approach, on the other hand, celebrates the importance of the dimension of time and supplies a reasoned and a theoretically supported account of the skeleton of world history over the past 1,000 and more years. It is no mere catalogue of dates and events, but a systematic account of why the world is shaped the way it is today.

The evolutionary story is hardly all there is to world history of the past millennium, if the latter is thought of as the comprehensive record of politically significant developments the world over. It does not aim to be an encyclopedia of world facts or full rendering of planetary happenings. It is not Eurocentric (see EUROCENTRISM), in that it emphasizes worldwide political orderings, but it is not Asia- or Sinocentric either, even though (as far as we can tell) for most of world history a majority of the world's population, between 50 and 60 per cent, did live in Asia, and many in China. It asks, on the other hand, what have been the principal sources of political innovation, institutions and organizational change, and where, in any given period, have conditions been suitable for forwarding such developments; in other words, which have been the active zones of the world system, and what (and at what times) did they contribute to global political evolution.

The second main application concerns the future (Modelski and Thompson, 1999). A good theory provides a handle for what is to come and a learning-type theory is particularly well-suited to that task. The theory deals with processes that are long-term in nature and serves to illuminate structural trends with generation-long phases in world politics, and as related to economics and to democratization. This is not a matter of foretelling events, but of providing a stable framework capable of guiding expectations of likely developments within well-specified timeframes: twenty-five to thirty years, fifty to sixty years, even a century ahead.

Matrix of evolutionary world politics

The matrix of evolutionary world politics,

shown in Table 2, helps with both types of application. It is, in the first place, a succinct summary of a millennium of evolutionary change in world politics. It shows three major periods of global evolution – (a), (b) and (c) – each located in a different zone of the world system. At the middle level, in each of these periods, the four rows indicate successive major powers holding the lead position and the global problem that defined their tenures. In each individual row (at the micro-level), the four cells describe the phases of the process by which a world power (for example, Britain in its second hegemonic phase in LC8) attained the position of global leadership: the phases of ‘agenda-setting’, ‘coalition-building’, ‘macro-decision’ and ‘execution’ (the four components of the learning algorithm). The entire matrix tells ‘a brief history of global politics’.

In the second place, the matrix also extends into the future and forms the framework for discussing the shape of global politics in the twenty-first century. Of especial significance is Row 10 (LC10), in which the premier global problem is shown as one of *INTEGRATION* (or formation of civil society at the global level on a democratic basis) as the foundation on which a political framework might arise in the twenty-first century. By 2000, global politics has entered the phase of ‘coalition-building’ (Column 2), for which the principal expectation centres around the emergence of the nucleus of a global democratic community. Great interest attaches to the shape of the phase of ‘macro-decision’ (after 2026).

Finally, the matrix is itself also a preliminary test of the theory of evolutionary world politics. It demonstrates how the three levels at which these processes might be observed relate to each other in a nesting fashion and in a condition of self-similarity. But it is not the only effort at testing aspects of this field. Substantial tests include those of sea-power periodicities (Modelski and Thompson, 1988), global leadership (Modelski and Modelski, 1988), land-power periodicities (Rasler and Thompson, 1994), and politics and economics of co-evolution (Modelski and Thompson, 1996).

Co-evolutionary processes

The matrix in Table 2 shows evolutionary world politics as though a stand-alone process. That is done solely for purposes of clarity of presentation. A more comprehensive analysis would show global politics to be one of a set of global evolutionary processes, of which the others are global economic evolution, democratization and the emergence of world opinion, and in relation to which one each is ‘co-evolving’.

Global economics

The relationship between evolutionary world politics and trends in the global economy is central to IPE, and is a relationship that over the past millennium has produced an increasing interdependence in the world system and increasingly open trade-regimes. At the basic level, the trend is driven by surges in leading industrial and commercial sectors – known as *KONDRATIEFF WAVES* (or *K-waves*) – of an average length of some fifty to sixty years. Global powers successfully pursuing aspirations to leadership have at the same time been those leading in the cutting-edge industrial sectors of the global system. The *LEADING SECTOR* now entering on the stage of high-growth is that of the information industries (Modelski and Thompson, 1996). The evolution of the global economy spearheaded by such lead industries has in turn produced increasingly complex global economic organization, sponsored by global leadership.

Democratization

The decades since the mid-nineteenth century have seen the spread of democracy to an increasingly large proportion of the world’s population. In 1800, democratic societies counted fewer than maybe 5 million people; by the year 2000, that number stood at around 3 billion. At the close of the twentieth century and for the first time in the experience of the human race, a majority of the human species lives in democracies, in a rapid transformation

Table 2 The matrix of evolutionary world politics: ‘a brief history of global politics’

Agenda-setting (global problems)	Coalition-building	Macro-decision	Execution and next challenger
<u>(a) Eurasian transition</u>			
930	960	990	1020 LC1
Information	Sung founded	War with Liao	Northern Sung
1060	1090	1120	1160 LC2
Integration	Reform parties	War with China	Southern Sung
1190	1220	1250	1280 LC3
World empire?	Mongol confederacy	Mongols conquer China	Genoa and Mongol empire
1300	1320	1350	1380 LC4
Trade	Shipping links	Genoa and Mongols routed	Venice and Timur
<u>(b) West European</u>			
1430	1460	1494	1516 LC5
Discovery	Burgundian connection	Wars of Italy and Indian Ocean	Portugal and Spain
1540	1560	1580	1606 LC6
Integration	Calvinist International	Dutch-Spanish wars	Dutch Republic and France
1640	1660	1688	1714 LC7
Political framework	Anglo-Dutch alliance	Wars of Grand Alliance	Britain I and France
1740	1760	1792	1815 LC8
Industrial revolution	Trading community	Revolutionary/ Napoleonic wars	Britain II and Germany
<u>(c) Post-West European</u>			
1850	1878	1914	1945 LC9
Knowledge revolution	Anglo-American special relationship	World Wars I and II	United States
1973	2000	2026	2050 LC10
Integration	Democratic transition		
2080	2110	2140	2170 LC11
Political framework			

Source: Modelski and Thompson (1996)

Note: LC – long cycle of global politics (numbered)

(the 'democratic transition') that bears the hallmarks of an evolutionary process. Among those monitoring it as a global phenomenon have been Tatu Vanhanen (1997), who views it as evolutionary, and Alfred Somit and Stephen Peterson (1997), who see in it a defeat of biologically based authoritarianism.

Democratization is a learning process for humankind, creative of conditions for improved conditions of co-existence and consistent with the findings of Robert Axelrod (1984) about the 'evolution of cooperation'. The world powers have also been those forwarding the spread of democracy (pointing to the interdependence of global political and social evolution). A condition where world politics is majority-democratic is likely to create a substantially new environment for political action at the global level. In the early decades of the twenty-first century, the building of a democratic community among those societies will be an important matter for the foreign policies of the United States and the European Union, in particular.

World system evolution

Most basically, world politics must be situated not only side-by-side with the evolutionary processes of the modern era of the past millennium, but also in the context of the world system as a whole and its Ancient and Classical eras. The social organization of the human species – of which evolutionary world politics helps to understand only one limited part (that is, the world system) – has been underway for several millennia. This is the larger domain of world system evolution (Modelski, in Denemark *et al.*, 1999). At a time when humans are gaining an ever greater awareness of their place on this planet, in the universe and in time, IR and IPE students need to be confident that this type of evolutionary analysis will stand the test of application to the entire range of human institutional and organizational change.

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There is also a useful website, the Evolutionary World Politics Home Page, at <http://www.faculty.washington.edu/modelski>

GEORGE MODELSKI

exchange controls

Exchange controls are imposed by a state concerned with regulating the sale and purchase of gold and foreign currencies by residents of that state in order to influence the international value of its currency. Controls take a variety of forms – from direct quantitative restrictions placed on the external asset and liability positions of domestic residents to maintaining separate exchange rates for commercial and financial transactions (that is, what are known as 'dual' or 'multiple exchange rate' systems – see EXCHANGE RATE). It should be noted, however, that a currency is not fully convertible when an exchange control is in operation. The state undertakes a policy of

exchange control because it is reluctant to leave the value of its currency to be determined in the marketplace (as would be the case in a system of FLOATING EXCHANGE RATES) or to allow the fixed external value of its currency to be the determinant of the domestic price-level (as under the GOLD STANDARD). This reluctance is often for reasons of protecting domestic competitiveness. For example, a government wishing to safeguard domestic industries may attempt to maintain its exchange rate at an artificially low level. Foreign goods will be expensive in the domestic market, while domestic goods will be inexpensive abroad. Such a policy is, however, usually difficult to maintain. The national monetary authority, in attempting to hold the exchange rate down, has to buy FOREIGN EXCHANGE with domestic currency. This newly issued domestic currency will increase the domestic money-supply leading, in the end, to INFLATION.

Whether such controls work, then, is dependent on the government's ability to prevent financial flows through channels that either avoid detection or legitimately evade their control. This has been significantly undermined in recent years by the introduction of new financial services and the revolution in information technology. Exchange controls are discouraged by the ORGANISATION FOR ECONOMIC CO-OPERATION AND DEVELOPMENT (OECD) and other international organizations concerned with the encouragement of international trade.

See also:

capital mobility; convertibility, currency

ALISON M.S. WATSON

exchange rate

At a very general level, the 'exchange rate' is simply the price of foreign currency that clears the market for foreign exchange: the price (or rate) at which one currency is exchanged for

another currency, for gold or for SPECIAL DRAWING RIGHTS (SDRs). These transactions are carried out spot or forward in the markets for foreign exchange (see SPOT MARKET; FORWARD MARKET) and are very much determined by the conditions of supply and demand for the relevant currencies in the market at any given time. These conditions are in turn dependent, among other things, on the demand for currencies to meet obligations, expectations about future movements in the exchange rate, and the BALANCE OF PAYMENTS position of the relevant economies.

The behaviour of exchange rates is of vital importance to any state in the contemporary international political economy. Exchange rates link a country's macro- and micro-economies to the rest of the world through the asset market and the goods market. In macro-economic terms, this occurs in two ways. First, in the goods market, the exchange rate establishes a link between prices in the world economy and the given prices in the world market. Generally speaking, the higher the exchange rate, the higher the price of foreign goods in home currency. For a given level of domestic costs and prices, a higher exchange rate makes foreign goods less attractive to domestic consumers, while domestic goods become more attractive to consumers in the rest of the world. Second, in the asset market, the exchange rate is an important variable in the decisions made by domestic wealth holders over how that wealth is to be held. Their choice will depend on the trade-off between risk and return: the higher the return on foreign assets (in home currency) compared to domestic assets (provided there is no increase in the level of risk), the more chance there is that domestic residents will shift their wealth into foreign assets. For example, for an investment in pounds sterling to be competitive against an investment in US dollars, the interest rate on pounds (that is, the asset return) must be greater than the interest rate on dollars plus the expected percentage rate of sterling exchange-rate depreciation. If this does not happen and capital is mobile (see CAPITAL MOBILITY), then the United Kingdom would soon find that it

loses reserves through selling dollars to domestic residents who prefer them as an investment to the low-yield domestic currency assets.

In micro-economic terms, the exchange rate links a country to the rest of the world in ways that are of vital importance to the issue of resource allocation. In the goods market, when a change in the exchange rate makes an economy more competitive, resources are drawn into the tradable goods sector (that is, the number of tradable goods increases): more goods become exportable and fewer goods are imported. On the other hand, when a change in the exchange rate makes an economy less competitive, resources become primarily employed in the domestic market: more goods are imported and fewer goods are exported. Exchange rate changes therefore affect the allocation of resources in an economy because the distribution of income between different groups or sectors often depends on the level of competitiveness. For example, if a country has a traditional export sector (such as agriculture or mining), then an increase in the exchange rate will make these traditional exports more attractive to consumers in the rest of the world. This sector will then become more profitable. On the other hand, when the exchange rate decreases, firms in the traded goods sector become unprofitable and therefore cut back on investment. The traded goods sector shrinks. In the asset market, the effect of a situation in which the return on domestic assets is lower than the return on foreign assets is that CAPITAL FLIGHT will take place out of the domestic economy and into the foreign economy. Hence fewer resources will be available for investment in the home economy, which in turn will have an effect on the well-being of domestic firms and consumers.

The fact that the exchange rate engenders these links between a domestic economy and the rest of the world means that exchange-rate movements are closely monitored by a state's monetary authorities. Every country that possesses its own currency must decide on how that currency is going to be managed and to what extent, if at all, the national authorities will intervene in the FOREIGN EXCHANGE

markets themselves. For this reason, the value of the exchange rate is a topic that has long exercised the minds of policy-makers and academics alike. Indeed, from the 1870s until the 1930s, the exchange rate was one of the economic issues most hotly debated in both domestic and international forums. At that time, the GOLD STANDARD was in operation. Whether their national currency should be on or off the gold standard, and what the value of their national currency should be, was of constant concern to policy-makers. For example, the United Kingdom came off the gold standard in 1914, partly returned to it in 1925, but was forced to abandon gold finally in 1931 – though, according to one scholar, ‘to go off gold was thought of as unmitigated disaster, although no one was clear why ...’.

It is in more recent times, however, especially since the early 1970s, that the significance of the debate over exchange-rate policy has increased. This has been as a result, particularly, of changes in the international economic and political environment. The major turning point was the collapse of the post-war international monetary order (namely, the BRETTON WOODS SYSTEM) under which countries had maintained a basically FIXED EXCHANGE RATE arrangement with only occasional adjustments. These adjustments, moreover, tended to be devaluations by countries that were experiencing a balance of payments deficit, rather than revaluations by those countries who found themselves in balance of payments surplus. Thus the exchange-rate system that prevailed during the Bretton Woods era did not function symmetrically. Rather, the burden of ADJUSTMENT was borne by the weaker deficit countries, with the stronger countries accumulating increased reserves.

Nevertheless, its collapse left a vacuum, in that policy-makers no longer had to have their currencies pegged to the dollar; they could determine their own values within the new flexible exchange-rate system. Moreover, the transformation in international finance that has taken place in recent years – including the increasing dominance of institutional investors

and the development of new financial techniques and instruments – has meant that both official financial actors (such as finance ministries and national central banks) and private financial market actors (such as commercial banks and industrial corporations) have had to learn to deal more effectively with the implications of such developments.

See also:

floating exchange rates; international trade; investment; micro-economic policy

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ALISON M.S. WATSON

Exchange Rate Mechanism (ERM)

The Exchange Rate Mechanism (ERM) is a EUROPEAN UNION (EU) agreement intended to keep intra-European exchange rates within prescribed fluctuation bands (see EXCHANGE RATE). The majority of EU member-states belong to the ERM and the ERM forms the core of the EUROPEAN MONETARY SYSTEM (EMS), a broader framework agreement encompassing all of the EU members. Despite initial doubts about its viability at its creation in 1979, the ERM has displayed remarkable longevity, increasing exchange rate stability and broadening its membership. Indeed, the perceived success of the ERM contributed to a revived European integration movement, most notably the push for monetary integration and a single currency culminating in the plan for ECONOMIC AND MONETARY UNION (EMU) in the Treaty on European Union. Despite a series of exchange rate crises and the exit of several member-states in the 1990s, EU governments demonstrated a continued commitment to cooperating in the monetary realm.

European political leaders have sought to stabilize the value of their currencies *vis-à-vis* other EU states for three reasons. First is the belief that large swings in nominal currency values can disrupt trade and investment flows within the common market. Although there is little empirical evidence linking exchange rate volatility to a decrease in cross-border economic activity, volatility does make the EU's COMMON AGRICULTURAL POLICY (CAP) more complicated and costly to administer. Second, European leaders view fixed rates as a way to promote political unity within Europe, as many equate FLOATING EXCHANGE RATES with the economic dislocations and political conflicts of the inter-war era. A final, contemporary reason why member-states have pursued exchange rate cooperation is the perception that linking national currencies to a regime that includes the strong and stable Deutschmark (DM) will lower inflationary expectations and thus inflation itself.

The personal commitment of French President Valéry Giscard d'Estaing and German Chancellor Helmut Schmidt was crucial to the initial creation of the ERM. Schmidt's immediate concern was the appreciation of the German currency, which he feared would make German exports uncompetitive. More fundamentally, both Giscard and Schmidt viewed the international floating exchange rate regime which replaced the BRETTON WOODS SYSTEM as indicative of a broader decline in US leadership under President Jimmy Carter, one which (in their view) could only be met with a deepening of European economic cooperation and increased political unity.

The negotiations over the rules and operation of the ERM were highly contentious. The stronger currency countries (led by Germany's Bundesbank) insisted on insuring that the system would not be set up in a way that might dilute their anti-inflationary efforts, while the weaker currency countries (primarily France and Italy) pushed for a more flexible system to ensure their continued participation. In the end, despite some cosmetic innovations to the contrary, the stronger currency view prevailed and states were largely left responsible for adjusting their policies to stay within the EMS.

The ERM began in March 1979 with all the member-states of the EUROPEAN COMMUNITY (EC) (Belgium, Denmark, France, Ireland, Italy, Luxembourg, the Netherlands and West Germany), save the United Kingdom, participating. The UK entered only during the period 1990–2; Italy left the system between 1992–6. Of subsequent entrants to the EU, Spain, Portugal, Austria and Finland have all joined the ERM, while Greece and Sweden remain only in the EMS. Initially, member-state monies were supposed to vary against other EC currencies by plus or minus 2.25 per cent, but certain states have been allowed bands of 6 per cent and (after the 1992–3 currency crises) the general band was broadened to plus or minus 15 per cent, although in practice currencies largely traded within the narrow band limits.

The political logic behind cooperation in the ERM remains controversial among scholars. There is general agreement that the DM functioned as the anchor currency of the system, but the political implications of this are less clear. One interpretation is that the German commitment to price stability before, and sometimes at the expense of, other economic goals became increasingly popular with policy elites in the other EU states, particularly France, over the life of the ERM. This resulted in a convergence in monetary policies towards the German standard, and an eventual convergence in inflation rates, which underpinned increased stability in the ERM. While evidence can be found to support this thesis, it is also true that France and other states continued in their attempts to ease the burden of the system's operations on the weaker currency states, such as the Basle-Nyborg reforms of 1987. The proposal to move from the ERM to an EMU was also viewed by some as a way to ensure that decision-making over the direction of monetary policy would be shared among all member-states, not determined by *de facto* German leadership.

Developments in the early 1990s put a heavy strain on cooperation in the ERM. Internally, the EMS had become overly rigid as currency realignments ceased by the late 1980s, making the system ripe for attack by currency traders. Externally, the reunification of Germany and the uncertain process of ratification of the MAASTRICHT TREATY produced heavy waves of currency speculation against the member-states whose governments were perceived as being less committed to the system (such as the United Kingdom) or less able to stay within the system because of domestic economic problems or political pressures (such as Italy). A coordinated defence of the franc by France and Germany managed to keep the EMS intact at the core and, despite pressures arising from the move to EMU, the transition from ERM to single currency was relatively smooth.

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KATHLEEN R. MCNAMARA

exogenous factors

An exogenous variable is determined by factors outside a theory. The demand for corn depends on the price and other factors, including the weather in the corn-growing season. The weather is not determined by economic conditions and is an exogenous variable in the economic theory. It influences the price of corn, but the price of corn does not affect the weather.

See also:

endogenous factors

M. PETER VAN DER HOEK

exploitation

'Exploitation' is one of the most emotive words in the language of political economy. In one usage, the term denotes little more than the act of utilizing an available resource and using it to personal or common advantage. Exploitation has, however, some profoundly pejorative usages and implications.

In its pejorative sense, the term 'exploitation' denotes the act of taking unfair advantage of someone or something. As a loose expression of disapproval it thus serves effectively. The problems arise, however, when the general notion of unfairness has to be given substance and precision – when the question to be answered is: What exactly is unfair and under what conditions? The central difficulty here is that events and relationships in the real world do not come ready-labelled as instances of exploitation: an argument is always necessary to identify the existence and extent of a situation or relationship that warrants the term 'exploitation'.

The term ranges in its employment from the Marxists' identification (see MARXISM–LENINISM) of its centrality in all capitalist relations of production and exchange, to the ultra-liberal's virtual exclusion of the concept from all voluntary economic exchanges between human beings.

Within Marxist political economy, exploitation is not merely an incidental (albeit common) occurrence within CAPITALISM, but is definitive of it and its central features. Capitalism is defined for Marxists as a MODE OF PRODUCTION in which capitalists are, by virtue of their ownership and control of the land and equipment with which production is undertaken (the means of production), able to employ workers at rates of pay that are below the true value of the productive effort that the workers devote to the productive process. This ability to extract some of the value of what workers have produced – SURPLUS VALUE – lies at the heart of the profits that the capitalists are able to secure and the general process of accumulation. The extraction of such surplus value is what Marxists define as exploitation and is thus inherent in and central to the nature of capitalism.

Extreme proponents of the theory and practice of LAISSEZ-FAIRE – ultra-liberals – adopt an attitude towards the idea of exploitation that is diametrically opposed to that of the Marxists. Robert Nozick exemplifies this position with his argument that any exchanges between human beings that are entered into

voluntarily are inherently fair and cannot therefore be described as exploitative. Only where participation is coerced, in a direct and obvious manner, can any measure of exploitation exist in any exchange relationship between responsible human beings. Such a restrictive perspective rules out such notions as structural exploitation, with their reference to general patterns of inequality of wealth and opportunity that force individuals and societies into exchange relationships in which they are systematically disadvantaged.

Two polar extremes are offered by Marxist and ultra-liberal perspectives: the former defining all economic relations within capitalism as quintessentially exploitative; the latter deeming exploitation to be definitionally impossible in any uncoerced economic exchange or relationship. Between these two extremes, numerous approaches to the idea of exploitation compete for attention, but cannot secure the definitional simplicity and strength of the Marxist or ultra-liberal perspective.

The idea of exploitation has proved particularly important to those who adopt a critical approach towards contemporary economic arrangements, but feel unable to accept major features of the classical Marxist theory – particularly the much disputed LABOUR THEORY OF VALUE. Without such an idea of exploitation, statements about contemporary inequalities would either have to remain non-judgemental or resort to essentially impressionistic and *ad hoc* critical criteria.

Theoretically, many of the systematic attempts to define and identify exploitation start from a repudiation of the marginal productivity theory of income distribution within a market economy. The general level of wages prevailing within any economy is not, according to this critical view, established by some objectively determined level of productivity of its workforce – productivity conditioned by levels of skill, knowledge, experience and effort. Rather, the general level of wages is set institutionally by the specific combination of local economic bargaining powers and the location within the pattern of international specialization and technological distribution

that is peculiar to any economy. The general tendency towards the equalization of the rate of profit internationally impacts on such factors to establish the basis for an iniquitous pattern of international exchange – or exploitation.

For Arghiri Emmanuel, such an interpretation of the international division of labour (see DIVISION OF LABOUR, INTERNATIONAL) and reward crystallized into a quasi-Marxist theory of UNEQUAL EXCHANGE. In the hands of a wide group of followers of PIERO SRAFFA, such conceptions underpinned a systemic (but non-Marxist) critique of the structural inequalities characterizing relations within and among contemporary capitalist economies. In both interpretations, it is the differential pattern of bargaining power and access to technology that underlies the unequal and ultimately exploitative distribution of reward between capital and labour, or between rich developed economies and LESS-DEVELOPED COUNTRIES (LDCs).

Exploitation is thus an emotionally and politically charged idea which can be given substance only within a governing theoretical perspective. Only when the contending theoretical perspectives that generate alternative views of exploitation have been explicated and evaluated can the existence and extent of such exploitation be established empirically.

See also:

institutionalism: neo-Ricardian (post-Sraffian) theory; structuralism

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R.J. BARRY JONES

export credit and guarantees

Many countries have public bodies which provide export CREDIT and insurance. Buyer credit insurance guarantees domestic banks and financial institutions against default on loans extended to overseas borrowers, while supplier credit insurance is extended to domestic suppliers against non-payment by overseas purchasers. This type of assistance to exporters and the liquidity it generates for the country in receipt of the goods, is large compared to public AID assistance. For poor areas falling outside insurable areas and activities of the private market, recourse to guaranteed credit from quasi-public financial institutions is necessary to facilitate trade.

The states of the richer countries in the global economy began to provide trade credit insurance and foreign investment guarantees from the 1920s onward, adopting the governing norms of the earlier London-based private insurance regime. From the 1970s, and particularly following the DEBT CRISIS, greater creditor coordination through international organizations like the PARIS CLUB has constitutionalized standards of practice. However, a result of this has been a widespread withdrawal of export credit from indebted areas, which has, in turn, had a detrimental effect on their ability to participate in the global economy.

export of capital

From the different perspectives of political economy, state provision of export credit guarantees could either be seen as legitimate SUBSIDIES or RENT-SEEKING behaviour. From a PUBLIC GOODS standpoint, the government would be intervening in imperfect markets to correct MARKET FAILURE, meeting a proportion of the 'excess demand' for export credit. As rent-seeking behaviour, exporters are negotiating a government guarantee for an overseas market, thereby reducing their risk (though not their profit) nearly to zero. From a Marxian perspective, the activities of export credit agencies involve a transfer of public funds to serve private accumulation: a socialization of risk and cost which serves a private accumulation of profit.

See also:

financial institutions

SARAH BRACKING

export of capital

'Export of capital' is buying and selling stocks internationally, loans to foreign countries, the repayment of credits that have been made by foreign countries and FOREIGN DIRECT INVESTMENT (FDI) in manufacturing.

In the nineteenth century, the export of CAPITAL was primarily connected to banking activities. Capital export manifested itself in the provision of international loans and other foreign credits. Today, export of capital is carried out by governments or private individuals, especially MULTINATIONAL CORPORATIONS (MNCs), through FDI. MNCs used to be primarily fully or partly state-owned, but since the 1980s have become increasingly privatized (see PRIVATIZATION). Export of capital in the form of FDI is usually a long-term investment by individuals or firms who keep themselves in a position to decide on the transfer of resources in which they have invested. Parts of the export of financial capital are internationally organized by international

institutions such as the WORLD BANK. The World Bank regulates the money transfer from developed to developing countries that is aimed at supporting their economic development. Although FDI in THIRD WORLD countries is made attractive for MNCs because of low tax or the absence of duties on imports, most FDI is concentrated on the developed and richer developing countries.

MEHDI PARVIZI AMINEH

export promotion

The term 'export promotion' refers to government efforts to increase exports, on the assumption that they can improve not only foreign-exchange earnings but also productivity and growth. Historically, export promotion (and restrictions on imports) were justified on mercantilist grounds (see MERCANTILISM): they contributed to national wealth through the accumulation of specie. The government chartering of trading companies (such as the British EAST INDIA COMPANY) reflected such mercantilist motives. Somewhat different mercantilist motives arose during the GREAT DEPRESSION of the 1930s, when exchange-rate policy and the formation of exclusive TRADE BLOCS were used implicitly or explicitly as export-promotion measures. Competitive devaluations or BEGGAR-THY-NEIGHBOUR POLICIES reflected efforts to maintain export competitiveness in the face of collapsing demand. Increasingly, closed imperial trading blocs were designed to provide protected markets for exporters as well: the British system of IMPERIAL PREFERENCES, the Nazi trading system in Central Europe and Japan's East Asian Greater Prosperity Sphere exemplify these trends.

In the post-war period, export promotion in Europe and Japan sought to overcome the severe foreign-exchange constraints associated with reconstruction. Japan, in particular, pioneered a new model of trade policy that combined relatively restrictive policies towards imports and inward foreign investment with aggressive promotion of export industries.

Japan's use of SUBSIDIES and other instruments of industrial policy was initially tolerated by the United States, Japan's most important export market, because of larger geostrategic concerns. Absorption of Japanese exports served to cement an important alliance. By the 1960s, however, Japan's export promotion efforts had become the subject of political resistance in Europe and the United States. Over the next three decades, Japan's industrial policies were the centre of ongoing trade disputes.

DEVELOPING COUNTRIES did not initially show a strong interest in promoting exports. Dependence on the export of RAW MATERIALS was seen as increasingly vulnerable to international fluctuations and MULTINATIONAL CORPORATIONS (MNCs). While developing countries did pursue efforts to increase productivity in export industries and stabilize earnings through international commodity agreements (ICAs), the main thrust of policy turned away from exports towards the development of domestic industrial capacity.

The overvalued exchange rates and protectionist trade policies associated with these efforts had the unintended consequence of deterring exports. As a result, a number of developing countries, particularly in Latin America, supplemented their IMPORT SUBSTITUTION INDUSTRIALIZATION (ISI) efforts with various subsidies to exports.

The emergence of the East Asian NEWLY INDUSTRIALIZING COUNTRIES (NICs) as highly successful exporters of manufactures stimulated an extensive debate over the sources of their success. Neoclassical interpretations (see NEO-CLASSICAL ECONOMICS) emphasized that 'export promotion' was really a misnomer, since exports emerged naturally as a result of appropriate EXCHANGE RATE policies and the LIBERALIZATION of trade. Once policy biases fell, domestic entrepreneurs and foreign investors had strong incentives to exploit low-cost labour in export-oriented activities and countries gained not only from increases in output but also from exposure to competition and access to new technologies.

However, the NICs' export-promotion efforts went far beyond getting prices right. At a

minimum, all of the East Asian NICs developed sophisticated government-organized marketing efforts that served to connect domestic entrepreneurs to foreign markets. Such government marketing efforts are now a staple of commercial policy in most countries, both developed and developing, and are even undertaken by subnational governments.

Export-promotion efforts also included the formation of EXPORT-PROCESSING ZONES (EPZs) and the encouragement of export-oriented FOREIGN DIRECT INVESTMENT (FDI). Free-trade enclaves provided foreign investors with infrastructure and logistical support for export-oriented manufacturing. The EPZ model was pioneered in Korea, Taiwan and along the Mexican border with the United States, but rapidly spread elsewhere, from Ireland to Bangladesh. The 'special economic zones' in China became laboratories for that country's initial export-promotion efforts. More broadly, links with MNCs and buying groups were important for developing marketing channels to the advanced industrial states.

More controversially, export promotion frequently included the use of subsidies of various sorts – either direct (for example, in the form of subsidized credit to exporters) or indirect (subsidies for RESEARCH AND DEVELOPMENT (R&D) in potential export industries). The pricing of exports by STATE-OWNED ENTERPRISES (SOEs) also became a subject of contention, since such enterprises often enjoyed hidden subsidies of various sorts.

Subsidies became a major issue in trade politics beginning in the 1970s. The GENERAL AGREEMENT ON TARIFFS AND TRADE (GATT) had always prohibited direct export subsidies, but international discipline was loose and developing countries claimed that they should not be bound by it. Developing and socialist countries increasingly became the target of COUNTERVAILING DUTIES targeted against subsidies, real or imagined. Sectors such as steel in Europe and the United States aggressively used subsidy laws to seek protection from imports. In the TOKYO and URUGUAY ROUNDS, discipline over subsidies tightened dramatically, but

Export-Import Bank

left some continued room for subsidization of basic and some commercial research.

See also:

commodity chains; economic realism; neo-mercantilism

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STEPHAN HAGGARD

Export-Import Bank

The Export Import Bank of the United States was created in 1934 to facilitate US exports, principally by providing aid in financing. A government-held corporation, the bank has historically filled gaps created when the private sector is reluctant to engage in export financing, and has provided a model for similar institutions worldwide.

JASON P. ABBOTT

Export-Import Bank of Japan

Originally established in 1950 as part of the DODGE PLAN, Japan's Export-Import Bank supports Japanese exports mainly through the use of SUBSIDIES. Subsidies usually take the form of low-interest loans. Although most assistance goes to Japanese businesses, support is not limited to Japanese firms. For example, the bank has given financial assistance to US firms that are modifying products for the Japanese market. Efforts by the bank to promote imports notwithstanding, its main charge is to boost Japanese exports.

JONATHAN R. STRAND

export-led growth

The relationship between exports, ECONOMIC GROWTH and DEVELOPMENT, and the differences between EXPORT PROMOTION and IMPORT SUBSTITUTION INDUSTRIALIZATION (ISI), have been a subject of much interest in development literature. Those advocating export-led growth usually do so on the basis that it is the rational and efficient alternative to other strategies of development. Outward orientation and export-led growth are argued to generate the necessary flexibility in shifting the economy's resources to take account of the changing pattern of COMPARATIVE ADVANTAGE (World Bank, 1987).

This changing pattern has been explained by the replacement of comparative advantage in land/resource intensive commodities to a comparative advantage in unskilled-labour intensive commodities. DEVELOPING COUNTRIES have, therefore, been advised to specialize in the production and export of unskilled-labour intensive products. Exports, it is argued, will lead to faster economic growth by (a) increasing the rate of capital formation; (b) increasing specialization and expanding the efficiency-raising benefits of comparative advantage; (c) offering greater ECONOMIES OF SCALE; (d) affording greater capacity utilization, and (e) and inducing faster TECHNOLOGICAL CHANGE (Bhagwati and Srinivasan, 1978).

Export-led growth has shaped the development policies of the WORLD BANK. 'Which trade strategies have enabled countries to attain high growth and to develop their industrial potential?' was the main theme of World Bank's 1987 *World Development Report*. The *World Development Report* concluded that 'rapid growth and efficient industrialization [were] usually associated with outward-oriented [export-led growth] policies on trade' (World Bank, 1987: 92).

The export-led growth strategy has been implemented most successfully in East Asia, where seven countries (Hong Kong, Singapore, South Korea and Taiwan – see FOUR TIGERS (ASIAN) – along with Indonesia, Malaysia and Thailand – the three Little Tigers of South-East Asia) have set the pace for the rest of the developing world in using outward-looking strategies to stimulate rapid growth and industrialization. The Four Tigers, or NEWLY INDUSTRIALIZING COUNTRIES (NICs), are primarily exporters of manufactures, while the three South-East Asian countries are still moving from their primary export bases toward greater reliance on manufactured exports.

Attempts at generalizing from the experience of these seven countries have focused on identifying a common set of elements (Lindauer and Roemer, 1994). First, these seven governments gave high priority to rapid economic development; corruption and RENT

SEEKING, though present, were kept within limits and ultimately subordinated to economic growth. Economic technocrats were given substantial influence over policy and insulated from political forces. And, in South-East Asia, ethnic-minority Chinese citizens (as well as foreign investors) were encouraged to invest and expand their firms. Second, economies were managed soundly, with small BUDGET DEFICITS, moderate INFLATION and exchange rates (see EXCHANGE RATE) that did not stray from market-determined levels. Third, factor markets were highly flexible. Labour markets were not encumbered with controls. Though credit markets were repressed in most economies, non-favoured borrowers could seek loans either in active parallel credit or curb markets (as in Korea and Taiwan), or in overseas markets (as in the other five countries). Finally, exporters were able to import and sell at close to world market prices.

While proponents of export-oriented growth have a strong case, country experiences vary significantly, making generalizations much more difficult than suggested above. For example, in its 1987 *World Development Report*, the World Bank identified four types of countries with respect to their trade policies. The World Bank categories included strongly outward-oriented, moderately outward-oriented, moderately inward-oriented and strongly inward-oriented countries. For the period between 1953 and 1985, the Republic of South Korea, Singapore and Hong Kong were the only three countries listed as strongly outward-oriented. Brazil, Chile, Israel, Malaysia, Thailand, Turkey and Uruguay were the eight countries listed as moderately outward-oriented between 1973 and 1985.

In the case of Hong Kong and Singapore, industrialization began directly through production for exports. It has been argued that small countries like Hong Kong and Singapore had to enter the manufacturing exports market at an earlier stage than resource-rich countries, due to their lack of an extensive base of natural resources. But, on the other hand, Chile, Israel, South Korea and Turkey, and almost all countries praised by the World Bank as

export-oriented industrialization (EOI)

outward-oriented in their trade policy, had experienced a long period of import substitution prior to entering the exports market. In fact, South Korea built a strong industrial base and competitive edge in the period preceding the phase of export promotion. Having achieved extensive industrialization and high economic growth, Korea and similar nations entered the exports market in search of demand for their booming industries.

In sum, a very strong case can be made for export-led growth. While perhaps not as convincing, a still credible argument can also be put forth that in many cases export growth itself is preceded by a period of economic development and as such is actually caused by the process of development and structural change.

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ROBERT LOONEY

export-oriented industrialization (EOI)

This strategy for industrialization emphasizes the key role which exports play in the overall DEVELOPMENT process. One can distinguish two different views here. The first emphasizes that rapid export growth causes the transformation from a less developed agrarian economy to a more developed industrial economy. Thus the driving force in economic develop-

ment is external to the domestic economy. More simply, this is EXPORT-LED GROWTH.

Within the context of export-led growth there is, however, some confusion. Most LESS-DEVELOPED COUNTRIES (LDCs) have followed IMPORT SUBSTITUTION strategies of development which involve the protection (via TARIFFS and QUOTAS) of domestic producers of manufactured goods. This results in resources being allocated to the production of import substitutes and away from the production of exports. Export growth tends to decline. The second version of export-oriented industrialization can, then, be seen as a set of policies which exactly effect those represented by import substitution. Specifically, this could involve the elimination of tariffs and quotas (free trade) or the use of subsidies which directly offset the effects of tariffs and quotas. Thus a neutral set of incentives is instituted within an economy. Resources will flow back towards export production and exports will grow. A more extreme version of export-oriented industrialization involves tilting incentives towards production for foreign markets. This involves actually subsidizing the production of manufactured goods for export.

Both of the above views of export-led industrialization emphasize that it is rapid export growth which ignites the industrialization process. This is generally thought to result from the fact that rapid export growth will allow firms to reap increasing returns to production on a large scale. In addition, new technology is often embodied in new forms of capital. Thus achieving more rapid technical innovation requires the rapid importation of new machinery. Rapid export growth provides the revenue necessary to finance these imports. In addition, the competition introduced via active engagement in world trade is likely to reduce monopoly power within nations and thus raise the overall standard of living.

There is, however, an alternative view of EOI. It implies that rapid export growth is the result of charges internal to a nation, not external. Specifically, rapid growth of investment in both human and physical capital result in rapid growth in productivity. This in turn

allows domestic producers of manufactured goods to displace imports from other countries. As this process continues, the country will eventually become an exporter of manufactured goods. The rapid growth of INVESTMENT required for this to occur is thought to require coordination by the state. In this situation, export growth certainly augments the growth process, but the ultimate source of dynamic development is internal in nature.

The views of EOI all attribute some degree of importance to export growth. The externally driven models view export growth as a direct causal force in industrialization. The internally driven models see exports as a result of rapid economic transformation. However, even in this case export growth is seen to add to the welfare of a nation. All of these views tend to ignore the possibility that rapid export growth for the bulk of the developing nations may not be a realistic possibility. Export-oriented development may lack viability if the developed nations close off their markets to exports from developing nations. This would be the result of increasing protectionism from the developed countries. In this context, the power exerted by the developed nations would serve as an effective barrier to rapid export growth for the bulk of the developing nations.

See also:

developmental state; industrial policy; inward-looking development

Further reading

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RICHARD GRABOWSKI

export-processing zones (EPZs)

Export-processing zones (EPZs) is the name given to areas or regions within a country in which foreign companies are able to set up processing plants for the purpose of exporting and in which they enjoy certain privileges not available to other firms. In particular, they are allowed to import components and parts for further processing at zero or very low TARIFFS. In addition, they may enjoy exemption from the country's minimum wage laws and other kinds of restrictive legislation, and enjoy use of cheap or subsidized parts of the infrastructure, such as port facilities, power supplies and so on. Newly industrializing countries (for example, Brazil, Hong Kong, Malaysia, Mexico, the Philippines, Singapore, South Korea) have made great use of EPZs as a device for attracting so-called export platform investments (that is, the establishment of subsidiaries or affiliates to produce a product for export only). From the point of view of MULTINATIONAL CORPORATIONS (MNCs), the attraction of this kind of investment is that it can be much cheaper than locating the assembly stage (which is often a relatively labour-intensive operation) in a developed country where labour costs are higher.

See also:

division of labour, international; newly industrialized countries (NICs); vertical integration

NIGEL GRIMWADE

EXPROPRIATION OF INVESTMENTS

see nationalization of investments

externalities

Externalities occur where market-priced transactions do not fully incorporate the benefits or costs associated with transactions, providing a case for government intervention in the market. They may be real or pecuniary. Real

externalities

externalities affect firms' production functions or consumers' utility functions. Pecuniary externalities affect the price vector, arising where ECONOMIES OF SCALE from production by one agent reduce the price for others. Static externalities occur with given technologies; dynamic externalities arise from innovations. Environmental effects form an important source of static externality. Dynamic and pecuniary externalities are particularly relevant to DEVELOPING COUNTRIES, where worker training and the spread of innovations form pervasive real externalities, while pecuniary externalities are especially significant in small

markets. Where externalities are large and few agents are involved, private action may 'internalize' them, but if many agents are affected government intervention is needed. For developing countries, this may require INFANT-INDUSTRY PROTECTION or special promotion of industries exhibiting large dynamic externalities.

See also:

market failures

FRANCES STEWART

F

factor endowments

What determines a country's COMPARATIVE ADVANTAGE in the production of goods and services? What explains the trade flows observed around the world today? Several theories and empirical analyses in international trade have been advanced to explain why trade takes place among countries. Most economists have followed the neo-classical explanation and believe that factor endowments go a great way to explain international trade patterns (see NEO-CLASSICAL ECONOMICS). Factor endowment can be defined as the quantity and quality of the factors of production – land, labour, capital and natural resources – that a nation possesses.

The Heckscher-Ohlin (H O) theory, which expanded and elaborated on DAVID RICARDO's theory of comparative advantage, ties the theory of comparative advantage to factor endowments. It proposes that goods can be produced with differing proportions of factors and that factors are mobile between sectors but immobile between countries. According to the H-O theory of international trade, a country will be able to produce at a lower cost (and therefore have a comparative advantage in) those products whose production requires relatively large amounts of the factors of production (that is, factor endowments) with which the country is relatively well endowed. For instance, countries with relatively large amounts of land relative to other factors (for example, Australia, Canada) will have a comparative advantage in producing goods that require relatively large amounts of land for efficient production (for example, wheat). We also expect Hong Kong, for example, to

have a comparative disadvantage in wheat production. It is also implied that countries that have labour forces that are large (labour abundant) relative to their capital stocks will have low wages relative to interest payments (that is, the returns to capital).

Because countries differ in their endowments of factors of production and goods differ in the factor mixes with which they can be produced, these differences affect costs in individual industries. For example, countries with a lot of capital are the most efficient in the production of capital-intensive goods, while countries with a lot of fertile land are the most efficient in the production of agricultural products, for example, foodstuffs and raw material inputs. For the United States (and most advanced countries) the capital/labour ratio is expected to range widely from a low in the apparel/textile industry to a high in the petroleum and chemical industries. Over time, the capital/labour ratio is expected to rise in all industries, but the ratio is not expected to show any dramatic change.

Nations' endowments with factors of production change over time, but generally we expect the industrialized countries, on the one hand, to be well endowed with capital and less so with unskilled labour. Developing countries, on the other hand, are well endowed with labour and less so with capital. Accordingly, international trade takes place as a result of these differences in factor endowments and, by implication, the greatest benefit from trade will be derived from those between the industrialized and developing countries.

In terms of the distribution of factors among countries, Australia and Canada are rich in fertile land and have a comparative advantage in grain-growing, whereas countries like Japan,

factor mobility

Sweden, Belgium and the Netherlands are well endowed with capital and have a comparative advantage in capital-intensive industrial commodities. The capital/labour ratios of countries show that Switzerland and Germany are among the most capital endowed countries of the world. Not surprisingly, there seems to be a correlation between capital abundance and economic development. The poorest countries have the lowest capital/labour ratios.

The factor endowments argument to trade quickly became popular because of its simplicity, logical completeness and ease of manipulation. It also has the capacity of providing important insights into the effects of international trade on factor prices (for example, wages) and the impact of economic growth on the pattern of international trade, and of explaining the socio-political behaviour of various interest groups in an economy.

See also:

absolute advantage; comparative advantage; factor price equalization; Heckscher-Ohlin-Samuelson (HOS) model of trade; Leontief paradox

Further reading

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EMMANUEL CLEEVE

factor mobility

Factor mobility indicates the mobility of the production factors capital and labour. Although, in theory, both are equally mobile, in practice this only goes for capital. Given certain cultural, emotional, social and economic barriers, in general people are not

willing to move to another city, region or country to find themselves another job.

N.M. DUYKERS

factor price equalization

In 1948, PAUL SAMUELSON (professor at MIT and later Nobel Prize-winner in Economics) proved that, under certain assumptions, not only a convergence (which had been predicted by Bertil Ohlin in 1933) but a complete equalization in the prices of factors of production would be a necessary consequence of FREE TRADE. Free trade in goods leads to the international equalization of the price of each homogeneous good. Since the techniques used in the production of a given good are assumed to be the same across borders and its price reflects the cost of production, the price of each production factor will also be the same across borders, not only in relative but in absolute terms.

For this to hold, a number of restricting assumptions are necessary. Samuelson assumed a model with two countries, two goods and two homogeneous factors of production. The goods were freely traded between the countries at no extra cost (that is, no protection and zero TRANSPORT COSTS), but the factors of production were assumed to be immobile internationally. The production function of each good was the same in both countries and exhibited constant returns to scale; consumer demand functions were also assumed to be identical in both countries. PERFECT COMPETITION and full employment of the two factors were also assumed. Each of the two goods was characterized by the intensive use of one of the two factors of production and this was the case for all the relevant factor price ratios. The global supply of both factors in both countries was given (and therefore was inelastic to relative price changes). All these assumptions are standard in the HECKSCHER-OHLIN-SAMUELSON (HOS) MODEL OF TRADE. Under these conditions, factor price equalization requires that neither of the two countries becomes completely

specialized in one of the two goods through free trade. Should that not be the case, then only some convergence of factor prices could obtain. As countries specialize through trade, this increases the production of the good which uses the abundant factor intensively (thus raising the price of the abundant factor) and reduces production of the good which uses the scarce factor intensively (thus reducing its price). Globally, this would lead to factor price equalization under the assumptions above, unless complete specialization was reached beforehand. Under this model, factor price equalization is more likely:

- 1 The more similar the relative endowments of factors of production in the two countries.
- 2 The more different the relationship of factor use between the two industries for a given factor price ratio.
- 3 The higher the elasticity of substitution of factors in the two industries.
- 4 The less extreme the demand patterns in the two countries in the model.

The Factor-Price-Equalization Theorem is a central proposition of neo-classical trade theory (see NEO-CLASSICAL ECONOMICS) and has major implications for international political economy (IPE). First, it predicts that free trade has a redistributive effect on factor rewards at an international level. Second, if it holds then trade in goods is a perfect substitute for international factor mobility – that is, equal rewards to factors across borders can be achieved without any international factor mobility.

The theorem largely survives with more than two goods or more than two factors, provided that (plausibly) there are at least as many goods as factors. Modifying the other assumptions can have more damaging consequences for the theorem. Empirically there is little support for the theorem at the world level because too many of the assumptions posited by Samuelson do not hold. It may be more likely through free trade at a regional level, such as within the European Union, which has seen convergence in wage levels with very limited intra-European labour mobility (Tovias, 1982).

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ALFRED TOVIAS

fair trade

Fair trade is a highly contested concept. The resonance it finds with many is a function of its ambiguity and implicit normative content. Who, at first sight, could quarrel with fairness? However, a closer look at the various meanings that different actors employ to define fair trade reveals the underlying complexity of the concept and divergent interests that utilize a discourse of fair trade. To a neo-classical economist (see NEO-CLASSICAL ECONOMICS), all trade is by definition fair. If two parties engage in a trade, it is because both parties will benefit. To a (neo-)mercantilist (see MERCANTILISM; NEO-MERCANTILISM), fair trade means that neither party is taking advantage of predatory tactics, subsidies or protectionism – trade should take place on a 'level playing field'. A third conception of fair trade, here referred to as the 'social dumping' school, argues that trade is legitimate when no competitive advantage is gained by lower labour, health or environmental standards. Because dramatically different agendas and interests utilize the discourse of 'fair trade', it is exceedingly important to keep these varying perspectives in mind when the concept is encountered.

It is not an exaggeration to say that the neo-classical perspective on trade is that FREE

TRADE equals fair trade. From this perspective, trade is seen as being based on different endowments of land, labour and capital, as well as different utility functions (how much countries or people value a particular commodity). Trade between two parties is mutually beneficial (or it would not occur) and therefore efficiency enhancing. It follows that maximizing trade is always desirable. To the mercantilist who is concerned about the predatory practices of DUMPING or subsidizing of the export sector by other countries, the neo-classical school would respond that such practices actually benefit the consumers of the importing country. According to the neo-classical view, mercantilist objections are a kind of Trojan horse masquerading as fair-trade concerns, the actual goal of which is to protect certain industries through tariffs (at the expense of consumers and global welfare more generally). The neo-classical response to social dumping objections would be similar. Either they are disguised protectionist arguments for a particular industry or group, or the arguments are based on faulty logic. The neo-classical perspective views differences in labour and environmental regulations as a legitimate source of gains from trade. If countries price labour or value their environment differently, an efficient outcome will result from trade based around these differences. In this vision, restricting exports from these countries would be likely to harm those it is intended to help; further, EXPORT-LED GROWTH is seen as central to DEVELOPMENT, and development is expected to lead to higher labour and environmental standards. Restrictions on exports are seen as counter-productive as a tool to raise standards over the longer term.

Mercantilist arguments often make use of a discourse of fair trade. Firms and entire industries will plead for protection against imports that are produced 'unfairly'. This argument is based on mercantilist objections to subsidies and dumping. Myriad forms of state support can be considered subsidies – resources provided at below market or no cost to firms. Research funding, direct subsidies, special access to finance, tax abatements and

all manner of other assistance, real and contrived, have been suggested to be subsidies that result in unfair trade. Dumping is the practice of selling a product at a price below the cost of production or below the price charged in the home market, thereby driving competition out of business and allowing the realization of monopoly profits. For sectors that face intense competition from importers, it is tempting to argue that one's competition is dumping and to seek relief from the state. The potential for abuse, coupled with the exceedingly complex task of ascertaining the proper unit cost of an imported item, makes such claims common and often dubious. The success of this strategy is determined by the ability of claimants to 'capture' the state, which is facilitated by the use of the rhetoric of fair trade. States that face persistent trade deficits have also utilized fair-trade arguments to claim that export targets are restricting access to their markets through regulations and other non-tariff barriers.

The above perspectives on fair trade generally make their claims for fair treatment of states or firms. The 'social dumping' school arrives at claims for fair trade by analysing the effect of trade on workers and/or the environment. In a global economy in which labour is relatively immobile and capital is relatively mobile, it is in the interest of capital to relocate production to lower-cost labour environs (all else being equal). The same logic applies to environmental standards. Liberalized trading environments will encourage such capital movement. The social dumping school sees this sort of trade as putting downward pressure on labour and environmental standards. The crux of the matter for this school of thought about fair trade is that some practices are not legitimate sources of competitive advantage. While the specific practices vary from one commentator to the next, the right for labour to organize and bargain collectively, as well as some minimum standards of workplace safety and environmental safeguards are almost always present. The motivation behind such calls for fair trade can be particularistic in their desire to protect some specific sector or more

universalistic in the call for labour rights as central to the notion of human rights more generally.

The forms in which debates about fair trade have played themselves out have varied. The WORLD TRADE ORGANIZATION (WTO) does allow for countervailing duties to be applied against states accused of dumping. However, even when such practices are limited by membership obligations, states have pursued VOLUNTARY EXPORT RESTRAINTS (VERs) and ORDERLY MARKETING AGREEMENTS (OMAs) to circumvent tariff violations. The United States has been a vigorous prosecutor of dumping complaints in the form of the anti-dumping provision of Section 301 of the Trade Act of 1974, amended in 1988. An overwhelming number of these complaints have been judged by many scholars to have little or any merit. They seem to be an example of what has been called the 'new protectionism' – sophisticated legal and procedural tactics that ultimately have the same goal of more blatant tariff policies (now circumscribed by obligations under the WTO).

The call for fair trade in the arena of labour and environmental standards has been addressed by clauses that are attached to some trade agreements. The EUROPEAN UNION (EU) has incorporated a Social Charter with the goal of harmonizing labour and environmental standards. However, it has remained merely a goal and not a legally binding agreement. The NORTH AMERICAN FREE TRADE AGREEMENT (NAFTA) incorporated a side agreement on labour and environmental standards that has legal force, but has not resulted in many successful complaints. The INTERNATIONAL LABOUR ORGANIZATION (ILO) has numerous conventions that are designed to protect labour rights, but has no enforcement mechanism beyond individual states ratifying particular conventions.

An inescapable element of the concept of free trade is the metaphor of competition. Firms or countries are conceptualized as being rather like athletic teams locked in competition, where only one can emerge triumphant, the others necessarily the vanquished. The notion of the 'level playing field' is a common

example. However, this metaphor is problematic in that firms and countries may not be in competition in a zero-sum game. Indeed, the intellectual power of the free-trade story owes much to the positive-sum nature of trade. Many examples of trade can be conceived of as mutually beneficial exchanges where both parties gain. When encountering the metaphor of trade as competition, it is wise for the observer to interrogate the claims of those seeking to cast the debate in terms of a football match.

The battles about fair trade are explicitly political due to the inherently subjective nature of the term. Fair trade is always a contested concept, and will remain so. Those who argue that trade is always fair because parties agree to it, are likely to fail in their desire to banish the term. Two general types of fair-trade discourse will probably flourish well into the foreseeable future. The first is the mercantilist argument that seeks to expand export access and diminish import competition. The increasingly sophisticated methods of 'new protectionism', the continuing liberalization of trade and the move towards larger free-trade zones will almost assuredly be accompanied by concerns about fairness of trading partners and by appeals from firms for protection from more competitive rivals. The second discourse is the 'social dumping' argument, that seeks to limit trade competition around labour and environmental standards. As LEAST-DEVELOPED COUNTRIES (LLDCs) further liberalize their economies and steer their economic policies toward EXPORT-LED GROWTH, concerns regarding downward harmonization of labour and environmental standards will probably intensify. Fair trade is likely to remain a highly politicized and contested concept.

See also:

export promotion; labour relations; trade policy; trade theory

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fallacy of composition

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M. SCOTT SOLOMON

fallacy of composition

The 'fallacy of composition' is a term in philosophy that suggests it is erroneous to think that the attributes of a whole are necessarily shared by its constituent parts. For example, while the United States as a country is one of the richest in the world as measured by GROSS DOMESTIC PRODUCT (GDP) per capita, it would be a fallacy of composition to think that all individual Americans are rich.

In political economy, the fallacy of composition is most often used to understand the relationship between individual rational decision-makers and the supra-individual collective entities (such as social classes, groups or NATION-STATES) of which those individuals are constituent members. The fallacy of composition suggests that there can be a discordance between individual acts of RATIONALITY and the rationality of those collective entities – that is, even though all individuals act rationally, the outcome for the collective entities to which those individuals belong might be irrational and suboptimal.

Problems of the fallacy of composition are most discussed in RATIONAL CHOICE theory – a body of work frequently associated with NEO-CLASSICAL ECONOMICS (although there is a Marxian variant: 'analytical Marxism' – Elster, 1985). Within this literature, the fallacy of composition receives the most attention within:

- 1 GAME THEORY, where it is shown that collective outcomes are the consequence of a complex interaction among 'players' rather than the simple aggregation of isolated, individual rational acts;
- 2 ARROW's impossibility theorem (see ARROW, KENNETH), which shows that one cannot consistently aggregate individual ordinal preferences into one collective ordinal preference function, and
- 3 WORK ON THE FREE RIDER PROBLEM and COLLECTIVE ACTION, which shows that the individual rational response to opt out of collective action ('free-ride') because of potential costs of inclusion may produce collective suboptimal consequences. For example, if all rational workers attempt to free-ride on union organization, then no union forms and collective benefits are forgone.

Partly as a result of the explicitly philosophical bent of analytical Marxism (and in particular Elster's work from 1985), the fallacy of composition has been used recently to reinterpret two central issues within Marxian political economy. The first is around Marx's thesis of the FALLING RATE OF PROFIT (FRP). That thesis suggests that individual capitalists rationally invest in increased levels of production machinery, each thinking that it will improve their individual profitability because of increased competitiveness. Paradoxically, though, when all capitalists act rationally, the result is declining profitability for the capitalist class as a whole. While Marx interprets this outcome as just another contradiction of capitalism, Elster's interpretation is in terms of the fallacy of composition: What is rational for the individual (the capitalist) is not necessarily rational for the whole (the capitalist class).

The second issue is around working-class collective action. Marx argues that it is in the best interests of workers to act collectively: 'Workers of the world unite!'. But if workers are individually rational, they will all attempt to free-ride on everyone else's class action and the result will be no collective action at all. Here, as Elster argues, the fallacy of composition becomes a barrier to working-class action

and the realization of the collective interests of the working class. Elster contends, however, that by posing the problem of working-class action in terms of the fallacy of composition, certain remedial strategies suggest themselves: for example, the need for close working-class social interaction and communication. For Elster, in this case knowing about the fallacy of composition can thwart the pernicious consequences of the fallacy itself.

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TREVOR J. BARNES

falling rate of profit (FRP)

The 'falling rate of profit' (FRP) thesis permeates almost every tradition of political economy. Classical political economy had a pessimistic view of the longer long-run prospects for the capitalist economy, maintaining that it is condemned to stagnation.

DAVID RICARDO founded the tendency to stagnation on a declining rate of profit, derived from diminishing returns – under constant technology – in the agriculture sector. In his 1817 essay, he considered a one-sector economy with one product (corn), being simultaneously the only input and output of production. The only capital necessary was variable capital for paying wages. The latter – via the typical Malthusian mechanism which was supposed to regulate the growth of the labour force – were considered tied to the level of subsistence. Then the rate of profit was determined by the ratio to the subsistence wage of the surplus corn produced by a worker on the least productive land in use. In Marxian terms, Ricardo was conflating the rate of profit $r = s/(c + v)$ with the rate of surplus value $s' = s/v$, since all capital was variable (where v is the rate of profit, s is the level of surplus value, c is the quantity of constant capital and v is the quantity of variable capital). The

Ricardian rate of profit was obviously equal to the ratio of the corn surplus to the corn wage (which is the equivalent of the rate of surplus value) on land that has zero rent. This rate of profit on the less productive land determined the rent on more productive land. Whatever a worker could produce on more productive land that exceeded the sum of their own wage plus the profit, would be paid as rent. As accumulation proceeded, more workers would be required. This increased demand for labour would temporarily increase wages and thus expand the population. A larger population would need more food, so production would have to expand to less productive land, falling prey to diminishing returns. This expansion would raise the value of corn and the value of the corn wage and lower the rate of profit, since the corn surplus produced by a worker on less productive land would be smaller than that produced on more productive land. Stagnation would become inevitable when the population grows so much that production moves to marginal land where workers produce solely their own wages, leaving no surplus for profit and thus reducing the profit rate to zero.

KARL MARX criticized Ricardo's theory for ignoring one of capitalism's major characteristics – competition-induced rapid technological innovation – which raises labour productivity and increases the profit rate. Marx's FRP thesis aimed to show capitalism's inherent crisis tendencies and that its very success (increased accumulation) is the cause of its own problems (crises). This stems from capital-labour class struggle in production and its association with intra-capital competition. The FRP stems from technical change and does not rest on the unwarranted assumption of a falling rate of surplus value. Capitalism has exhibited its ability to increase the rate of surplus value – particularly through the extraction of relative surplus value which is associated closely with technical change. The role of constant capital, which Ricardo neglected, is crucial in this process.

Capitalism's driving force – the quest for profit – compels each individual capital to

falling rate of profit (FRP)

struggle (1) in the labour process, against labour over the production of SURPLUS VALUE, and (2) in the circulation process, by competing with fellow capitalists for the realization of surplus value in the form of profits. Against labour, mechanization is capital's major weapon, since it strengthens capitalist control of the labour-process and the ability to change favourably the division between necessary and surplus labour-time. This enhances the production of surplus value via the extraction of relative surplus value, which is (for Marx) the form of exploitation pertaining to capitalism.

In intra-capitalist competition, each individual capital strives to reduce unit production costs (unit cost-prices). This requires the rapid introduction of capital-intensive and labour-saving technical change. For Marx, advanced production methods involve more capital-intensive plants in which, at normal capacity utilization, the unit production costs will be lower. By increasing the quantity of fixed capital per unit output, economies of scale are achieved. Because larger-scale production enables a given number of workers to process a greater amount of product, both raw materials and output per unit of labour tend to rise. At the same time, the greater amount of fixed capital per unit output implies higher depreciation charges and auxiliary materials costs (electricity, fuel and so on) per unit output. Consequently, for innovative production methods, the higher capital advanced per unit of output implies higher unit non-labour costs (unit constant capital) while the higher productivity implies lower unit labour costs (unit variable capital). For the innovation to be profitable, the fall in the latter must be greater than the increase of the former so that the overall effect would be the decline of unit production cost (the sum of unit constant and unit variable capital). However, under given technical conditions, existing technology and knowledge has definite limits. When these limits are reached, subsequent increases in investment per unit output will lead to smaller reductions in unit production costs. Therefore, the more advanced individual capitals would tend to achieve a lower unit production cost at

the expense of a lower rate of profit. The lower unit production cost enables them to capture a larger share of the market. At the same time, because the dominant market price is determined not by the more advanced individual capitals, but by the average conditions of production in each branch, innovating capitals supplement their profits by getting extra profits in the market. These are a net transfer of surplus value, generated under the auspices of other capitals who operate on average or below average conditions. These extra profits and the loss of market share compel other capitals to adopt the new production methods. However, this would sooner or later curtail the extra profits of advanced capitals, as their advantages would be eroded. When all production is stabilized at the new technical level, the result would be an increased rate of total constant over total variable capital and a lower general rate of profit.

The effects of the FRP can be temporarily offset by an increase of the mass of profit, through the expansion of production. However, sooner or later, the FRP weakens the incentive to invest, leading to the stagnation of the mass of profit.

FRP co-exists with a number of counter-acting tendencies: economies in the use of constant capital, emergence of new spheres of production where the organic composition of capital (OCC – the ratio of constant to variable capital) is lower (for example, less developed countries or new branches of production), intensification of exploitation, imports of cheap inputs and depression of wages below the value of labour-power (for example, due to increases in the reserve army of labour). Notwithstanding, FRP is the dominant side of this contradictory unity because the counter-tendencies operate within strict constraints. Thus, intra-capitalist competition induces rapid technical change, which increases the OCC, since it absorbs machinery faster than it employs workers. This relative displacement of workers by machines is met with definite limits in the ability to increase the extraction of surplus value.

FRP has been at the centre of modern debates. Most of its critics refer to the Okishio

(1961) theorem, which maintains that under certain assumptions (constancy of the real wage, perfect competition and so on), viable technical change raises the rate of profit. This has been disputed from different perspectives. One route has been the questioning of Okishio's assumptions. Duncan Foley (1986) has shown that with a wage rate rising to maintain a constant wage share of output, capital-using technical change lowers the rate of profit. Ben Fine (1989) also rejected Okishio's static equilibrium framework and argued that the FRP law is a contradictory unity of the central tendency (translating a rising technical composition of capital (TCC) to a rising OCC) and its counteracting tendencies (which affect the formation of the value composition of capital (VCC)). Another perspective accepts Okishio's assumptions but criticizes his definitions: Anwar Shaikh (1978) distinguishes between the rate of profit, estimated over total fixed and circulating capital (that is, covering the value of producer-durable goods which transfer their value over a number of periods), and the margin of profits, estimated over current costs only. Capitalists introduce new techniques which – by lowering current costs – increase the margin of profit but reduce the profit rate (through increased mechanization).

FRP relates to three other important theoretical areas. First, it has been proposed as the cause of capitalist economic crises (for example, Grossmann, 1992 – see also CAPITALIST CRISIS), contrary to under-consumptionist and disproportionality theories. Second, it has sparked a series of empirical enquiries on whether a secular FRP actually exists. Third, the relation between the FRP and economic fluctuations is at the heart of the theory of economic cycles.

See also:

business cycles; capitalist crisis; crisis theory; long cycles; Marx, Karl Heinrich; Ricardo, David

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STAVROS D. MAVROUDEAS

fascism

There is no clear, agreed definition of 'fascism'. Rather, the term has been used to describe a series of related phenomena and belief systems. Part of the reason for this is that those who have called themselves fascists never had a single and clear idea of what fascism meant. As a result, fascism has had three main meanings:

- 1 a description of the political programme of the Italian fascist party under Mussolini;
- 2 a term to describe right-wing populist totalitarianism, especially in inter-war Europe; and,
- 3 a particular authoritarian psychology associated with late capitalism.

Fascism is also commonly used as a form of insult between non-fascist political groups, the epithet 'fascism', in this case, being usually associated with anti-democratic bullying tac-

tics. In the NATO-Yugoslav conflict in 1999, for example, supporters of both sides referred to their opponents as fascists.

Many historians, among them Elizabeth Wiskemann, have been at pains to present fascism as a predominantly Italian political phenomenon, and to make a clear distinction between Italian fascism and German Nazism. Others have taken a broader view. Wilhelm Reich, for example, saw fascism as a psychological state common to many modern societies, with its roots in bourgeois views of sexuality and the family. Although considered a classic work on fascism, Reich's book deals only with the Nazis. Still others, such as Hannah Arendt and José Ortega y Gasset, have seen fascism as a reaction to modern industrial life. Numerous Marxist writers (among them Nicos Poulantzas) have seen fascism as an agent of late capitalism. Outside historical circles, it is fair to say that Wiskemann's definition is regarded as too narrow. With the rise of far-right groups in Europe and North America who profess to admire the ideas and leadership qualities of Hitler and Mussolini, the debate over fascism has developed a contemporary urgency that favours the definition of fascism as a broader problem of modern Western or Westernized societies. Much stress has been placed on fascism's character as an anti-ideology, whose force rests both in its opposition to SOCIALISM, LIBERALISM and CAPITALISM and in its simple belief in strong leadership and the primacy of the nation.

Other attempts to define the nature of fascism have examined its links with other political ideologies. The concern of fascist movements with the evils of industrialization demonstrate the extent to which it owes some of its character to the nineteenth-century Romantic movement. Nazi concerns for the honest yeoman craftsman (postage stamps of the period often depicted blacksmiths and other rural yeoman archetypes) and the Nazi hatred of bankers, are examples of this. The desire to heal the class rifts within the nation that had been caused by capitalism forms an important part of the ideology of fascism and

was clearly behind the establishment in Mussolini's Italy, for example, of joint worker-employer associations. But, as Herbert Marcuse has pointed out, despite the rhetoric of anti-capitalism fascist regimes in Europe did not challenge the capitalist basis of their societies. Major corporations continued to dominate Italy and Germany throughout their fascist periods, and industrialists remained among the key supporters of both Hitler and Mussolini. At the same time, however, fascism attracted many people from the Left, who saw in it a means of liberating the working classes from poverty. Oswald Mosley in Britain, Marcel Déat in France and Mussolini in Italy all came to fascism via socialism.

Key, though, to all forms of fascism was a strong belief in the primacy of the nation. This did not necessarily lead to racist policies, but more often than not this was the case. Italian fascism put the emphasis on converting minorities into cultural Italians, while the Croatian Ustashe advocated a mix of assimilation, expulsion and killing. For the Nazis, however, the extermination of 'unfit' Jews and Romanies became a central policy of the regime. Modern fascists and neo-fascists often target particular minorities, using them as scapegoats for what they see as the ills of society. Immigrants, particularly from non-Western parts of the world, have been a favourite target. In the United States, neo-fascist groups focus their racism on non-whites, particularly African-Americans. Common to all forms of fascist racism is a belief in the fascists' own natural superiority and the propagation of the idea that the 'inferior' groups are largely responsible for the problems of the nation as a whole. The tendency among modern neo-fascists has been to play down the anti-industrialism of earlier fascism and to concentrate on racism.

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LUCIAN M. ASHWORTH

fast-track authority

The US Congress and the President have designed elaborate procedures to expedite legislative approval of trade agreements. These procedures, first spelled out in the 1974 Trade Act, have come to be called 'fast-track authority'. They require all trade agreements to be submitted for ratification to the entire Congress, which then must say 'yes' or 'no' to the whole agreement in a deadline-driven, up-or-down vote, with limited debate and no amendments. Fast-track is intended to protect trade packages from being nibbled away bit-by-bit in long drawn-out debate.

Fast-track follows a prescribed sequence of steps leading to formal consideration by Congress. First, although not required, the President may announce a *handshake agreement*, allowing him to declare a deal and claim credit before all the actual terms are settled. Second, the *initialling of the agreement* launches the formal beginning of fast-track and serves as official notification to Congress that the President intends to sign an agreement. Third, the *final agreement* must be signed no later than ninety days after initialling, allowing some time for additional congressional input. Finally, *consideration by Congress* begins after the President has submitted three documents: the actual trade agreement, a draft bill changing existing law to comply with the agreement, and the necessary regulatory changes. The President may submit these documents any time after signing the final agreement but, once submitted, Congress has no more than ninety legislative days to act. Passage of the agreement requires a simple majority vote in both houses of Congress.

WILLIAM P. AVERY

Federal Deposit Insurance

The Federal Deposit Insurance Corporation (FDIC) was established by the US government in 1934 (along with the Federal Savings and Loan Insurance Corporation or FSLIC) in response to a period of instability in the American banking system. By guaranteeing deposits up to a certain maximum in the event of bank failure, the FDIC greatly increased the stability of the system: without deposit insurance fearful depositors can cause an otherwise healthy bank to collapse since the bank's assets (mostly loans) are longer term and not easily converted to cash. Deposit insurance can thus be an alternative to a LENDER OF LAST RESORT function, by which states provide liquidity in times of crisis. Deposit insurance has the disadvantage of MORAL HAZARD – insurance, by removing the threat of loss, can encourage risky behaviour and undermine the incentive to monitor risks. In the case of banks, depositors would see no reason not to shift deposits from prudently run banks to banks engaging in high-risk high-return activities. It was this type of problem that contributed to the Savings and Loan crisis in the United States, in which the FSLIC went bankrupt and the government was forced to step in with a \$150 billion rescue package. The US government sought to address such problems in its 1991 Federal Deposit Insurance Corporation Improvement Act which explicitly set out to alter the incentives for owners and managers in order to reduce risky behaviour.

The FDIC is engaged in international regulation through its membership of the BASEL COMMITTEE ON BANK SUPERVISION and through its monitoring of US offices of non-US banks. For instance, in 1995 the FDIC and other US authorities initiated criminal charges against and prohibited further US banking operations by Daiwa Bank, after it concealed \$1.1 billion in trading losses at its New York office.

TONY PORTER

Federal Reserve System

Founded in 1913, the Federal Reserve System is the public agency responsible for governing the American financial system. It is composed of thirteen regional banks and a national body, the Federal Reserve Board (or 'Fed' as it is commonly known). By statute this system is independent of the Federal government, although the President nominates key appointments and Congress must approve them. The various Federal Reserve Banks throughout the country oversee federally chartered financial institutions (including all of the country's largest banks), while the primary objective of the Fed is to set INTEREST RATES and conduct monetary policy for the country as a whole, principally through the operation of its Open Market Investment Committee. The Fed, together with the Treasury, is also responsible for the foreign-exchange value of the US dollar (see DOLLAR, US).

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RANDALL D. GERMAIN

federalism

Federalism is a system of government in which power is shared between a centralized authority (national state) and its constituent units (usually internal states or provinces). In a federal system, the political units possess at least some degree of autonomy from the central government, but all citizens share a common nationality and are subject to the authority of the national government. Generally a system is considered to be federal if it meets the following criteria: (1) at least two levels of government rule the same territory

and population; (2) each level has at least one area of action in which it is autonomous, and (3) each government has a constitutional guarantee of autonomy within its own sphere of jurisdiction.

Unlike a unitary system, where the constitutive units are subordinate to the central government, the sub-national governments in a federal system derive their authority from a constitution or charter. The national authorities cannot abolish the units and are legally constrained from interfering in matters that are within local jurisdiction. Unlike a confederal system, however, the individual units are not sovereign and are subject to the authority of the central government in a variety of matters that are deemed vital to the common good, such as defence and economic relations. The states or provinces within a federal system can be highly differentiated and there is usually no guarantee of social or economic equality among them.

The organization of the central government tends to reflect this arrangement. While there are various ways a federal system can be organized, most tend to include the following: (1) some form of representation from the citizenry within the constituent units, usually in proportion to their relative populations; (2) a form of equal representation from each unit; (3) a chief executive (prime minister or president) to act on behalf of the national polity, and (4) a high court that has the final authority to adjudicate disputes within and among the units.

The term 'federal' is derived from the Latin *foedus*, which literally means 'covenant'. As such, a federalist system is based on a contractual (constitutional) agreement between different levels of government that stipulates how power and authority will be allocated. This is usually done on the basis of function – for example, education, foreign relations and social welfare. While these types of power-sharing arrangements date back to the Greek city-state system of antiquity, federalism is largely a modern phenomenon, a product of the nation-state system. Unlike a medieval arrangement (where the relationship between

the ruler and the ruled is based on personal obligation), each unit's jurisdiction is solely territorial. They exercise authority over a defined geographic area rather than specific classes of people. The Swiss Federation is currently the oldest continuous form of this type, although the United States is often considered the first modern federalist state.

The federalist concept rests on the principle that political and social institutions are best established through contractual arrangements rather than growing organically. Thus, even those federal states that were founded on the principle of nationalism (for example, Germany) legitimize themselves through the concept of social contract. At its core, the principle of federalism tries to address a major problem of the modern nation-state: few states actually represent a single political or cultural community, yet the principle of exclusive SOVEREIGNTY and centralized power discourages diversity and local autonomy. Federal arrangements promote political expressions of diversity, accommodating it as a legitimate element in the polity. Federalism is therefore usually viewed as an attempt to reconcile conflicting national, ethnic, linguistic, racial and cultural claims arising out of historical experiences. It allows various groups to maintain the autonomy of their local customs and cultures, yet still participate in a larger political community.

At the same time, federalist arrangements prevent the concentration of political power within a single institutional structure, while still maintaining social cohesion. By creating a strong overarching government, federal states are able to pursue the same goals of political and economic integration as the Jacobin state. Yet, by providing for power-sharing with local units, it establishes limits on governmental authority. As such, it enables smaller political communities to enjoy the advantages of a large, centralized state without sacrificing their political autonomy.

The ability of federal systems to accommodate these conflicting tendencies is often mixed. Disputes between various levels of government are common and overlapping jurisdictions often lead to redundant and confusing admin-

istration. Moreover, by politicizing cultural and regional diversity, the 'common good' is often subordinated to parochial interest. This can contribute to a 'Balkanization' of the society and ultimately lead to disintegration. Because federal systems tend to be based on territorial divisions of power, territory becomes the foundation for political action. Numerically or politically weaker entities have less influence in government than their stronger counterparts, and the federalist structure limits the ability of the national government to equalize this relationship. In some cases the integration of diverse ethnic or cultural groups become unstable over time, particularly when there is inequality in power and influence.

Federal systems can be formed either through a devolution of power to local authorities by a unitary state (for example, in Belgium and Canada) or through the integration of previously sovereign units (for example, Germany or the United States). There are at least three models of federalism: American, Swiss and Canadian. In the American model, federalism is designed to provide a democratic alternative to the centralized, absolutist state, rather than to secure autonomy for local ethnic or cultural communities. Sovereignty is understood to be vested in the people and the various units of government (national, state and local) are said to exercise only delegated powers. The Swiss system is built on an accommodation of permanent indigenous ethnic and linguistic differences within the state. The Canadian model is based on the idea of a multicultural society combined with a parliamentary system along the lines of the British system.

Regardless of the type of arrangement, under international law and diplomatic practice, the national government of a federal state is recognized as the legitimate representative of the entire polity. The individual units are not recognized as international actors. They have no legal or diplomatic standing, nor do they have the capacity to enter into agreements with foreign states, unless the constitution of the federal state specifically grants it. The autonomy and identity of the constituent units is of domestic concern only.

Many unitary states adopt federal principles of organization without becoming federalist systems. A unitary state is considered to be using federal arrangements when there is a formal agreement between the entities involved that takes on constitutional force. Generally there are three other types of arrangements that fall short of federalism but contain federalist principles: legislative unions, decentralized unitary systems and consociational unions.

Legislative unions (such as the United Kingdom) can be described as ‘compound states’. They consist of polities that were consciously united out of what were formerly separate countries in such a way as to provide constitutionally for the preservation of some measure of local autonomy. Decentralized unitary states constitutionally guarantee autonomy to their local governments, but local power is restricted to matters determined by the central authorities to be local; even these are subject to national supervision and regulation. Consociations are unitary states comprised of ethnic, tribal, religious or ideological groups that are not organized territorially, but have acquired corporate characteristics of their own. As such, these groups have secured constitutional arrangements designed to preserve their integrity within a common polity.

Although most federal agreements result in the construction of a centralized nation-state, other forms of political organization may also be possible. For example, the EUROPEAN UNION (EU) can be considered a weak federal (or strong confederal) system, where authority is allocated both by function and geography between the states and the institutions of the Union. Within the EU, one can find a highly centralized authority in the area of trade; loose coordination of member-states in customs, immigration, foreign and defence policies; multilayered intergovernmental relations in structural policy; overlapping jurisdiction in employment, environmental and social policies; autonomous activity by states in social welfare, and increased interaction and coordination among regional institutions below the level of the nation-state.

In addition to federalism as a form of governmental organization, many non-governmental associations have used federal principles as a functional mechanism for sharing authority between the central organization and their local units. For example, labour unions are often organized along federal lines, resulting in large national labour federations. Similarly, business and industrial associations, transnational social movements, chambers of commerce and health and welfare federations often adopt federal principles of organization.

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BRUCE L. CRONIN

Fei–Ranis model

The model was originally published as Ranis and Fei (1961) and further elaborated in Fei and Ranis (1964). The intention is to make a contribution to the theory of growth ‘by

rigorously analysing the transition process through which an underdeveloped economy hopes to move from a condition of stagnation to one of self-sustaining growth' (Ranis and Fei, 1961: 533). The economy is a labour-surplus, resource-poor economy which must solve the Malthusian problem if the process of development along a BALANCED GROWTH path is to prove successful. A critical minimum effort is needed to achieve this objective. The model draws heavily on the work of ARTHUR LEWIS (1954, 1958) but argues that Lewis failed to provide a satisfactory analysis of the subsistence or agricultural sector, which must also grow if the mechanism of growth that Lewis described is not to come to a halt.

A simplified exposition of the model is given in Figure 4 (more complete versions can be found in Ranis and Fei, 1961; Fei and Ranis, 1964; Ghatak, 1995). The top half of the diagram represents the industrial sector, similar to the Lewis model; the bottom half represents the agricultural sector. The horizontal axis (O_1O_2) represents the total labour force with

industrial labour measured from O_1 to the right and agricultural labour measured from O_2 to the left. The curve O_2BA is the total product curve for food. The demand curve for labour is MPL_1 . Line w_1 is the supply curve for labour to the industrial sector. The marginal product (MP) of labour in the agricultural sector is zero for employment greater than O_2L_1 (L_1 = Phase I).

If the agricultural labour force is between O_2L_2 and O_2L_1 , the marginal product of labour is greater than the constant institutional wage rate ($w = O_2Y/O_1O_2$ = slope of line O_2A). Up to employment O_1L_1 (for example, MPL_1) in the industrial sector, the transfer of labour from the agricultural sector does not reduce agricultural output and labour is available to the industrial sector at the constant institutional wage rate (O_1w_1). When the demand for labour in the industrial sector exceeds O_1L_1 (for example, MPL_3), the transfer of labour from agriculture leads to a decline in food output, a relative increase in the price of food and a rise in wage rates in the industrial sector. Industry's demand-curve for labour shifts to

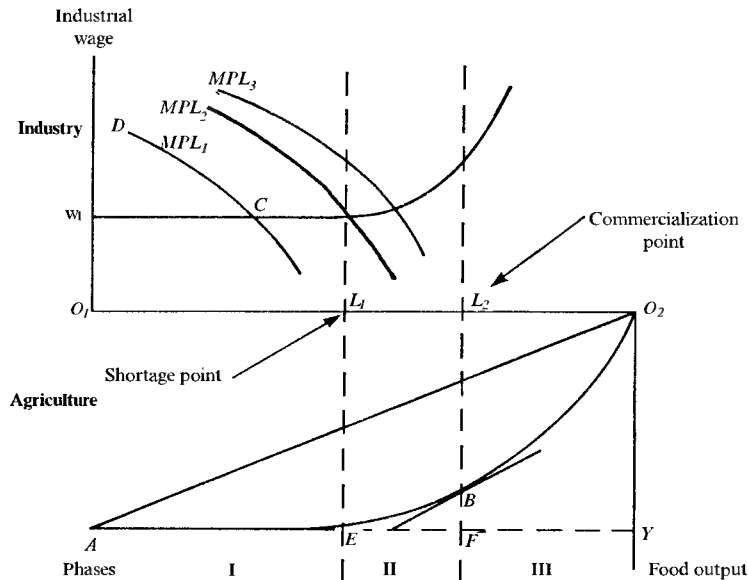


Figure 4 Simplified Ranis-Fei model

Source: Colman and Nixon, 1994: 40, adapted from Hayami and Ruttan, 1985.

the right (MPL_1 to MPL_2 , and so on) as profits are reinvested in the industrial sector (from DCw_1).

The three phases can be described thus:

In Phase I, MP of agricultural labour is 0 and there is surplus labour ('redundant labour' in Ranis-Fei terminology) equal to $AE (= O_1L_1)$.

In Phase II, the positive marginal product of labour is less than the institutional wage (O_1w_1) and Phases I and II indicate disguised unemployment equal to $AF (= O_1L_2)$.

In Phase III, MP is greater than O_1w_1 , the economy is now fully commercialized and disguised unemployment is exhausted.

The 'shortage point' (L_1) is the point at which (moving from right to left) the MP of labour becomes zero. The 'commercialization point' (L_2) is the point at which MP of labour equals the wage rate (at B where the tangent to the total product curve O_2BA is parallel to O_2A) and the upward movement of the industrial real wage is accentuated.

The Fei Ranis model emphasizes the importance of developing the agricultural sector and the need for balance between it and the industrial sector. Like most other dual-sector models, however, it requires the existence of an embryonic industrial (capitalist) sector as an initial condition, but does not describe where that sector comes from.

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FREDERICK NIXSON

feminism

Feminism is an interdisciplinary body of knowledge based primarily on the experiences and lives of women. It encompasses a variety of theoretical approaches. These include liberal, radical, standpoint, socialist, post-colonial and post-modern feminisms. All these approaches are seeking to understand the sources of women's oppression and prescribe strategies for ending it. Liberal feminists see the source of female subordination in legal constraints which block women's advancement in the public sphere. All other approaches identify deeper structures of inequality – variously associated with PATRIARCHY, RELATIONS OF PRODUCTION AND REPRODUCTION, class and RACE – which contribute in different ways to women's oppression. The term 'feminism' is also used to refer to political and social movements working to end women's subordination.

See also:

gender; patriarchy

ANN J. TICKNER

feudalism

Although it has been variously defined, in its strict sense, feudalism refers to the form of social and economic organization generally prevailing in western Europe between the tenth and fifteenth centuries AD. Medieval European feudalism of this sort may be considered the

'classic' form of feudalism and this description will concentrate on that form.

In medieval Europe, feudal society was organized around a series of ranked loyalties, in which each class or order of society owed absolute loyalty to its immediate superior. This led to a pyramidal social structure and an unequally 'upward' flow of resources. The patronage of feudal lords supported specialists (such as musicians) and craftspeople. At the bottom of this series of ranks were unfree or semi-free orders, notably 'serfs' – semi-free agricultural workers 'bound' by law to a specific locality. In a feudal society, each order owed both services and dues (usually in terms of food-rents or other produce) to their social superior. As all feudal Europe had agriculture-based economies, this social system therefore afforded a high degree of political and economic control to those near its top. This could be expressed in terms of landscape organization, as is found in the 'manorial system' of medieval England, as well as tenurial patterns and the flow of resources. A common (but not the only) form which this took was the clustering of the rural poor into villages, with each village having its own aristocratic residence (manor house) and church. In the surrounding landscape, cultivation plots might be divided into 'strips' – thin rectangular allotments each pertaining to a household – or into shared fields. The feudal elite maintained a close relationship with the rural economy in other ways, especially through the creation of hunting areas ('parks' and 'forests' – it is especially important to note that the latter were not entirely comprised of woodlands) and through their need for raw materials such as stone and timber.

The relative autonomy of the upper orders of society and the ranked distribution of political control, however, limited the ability of feudal rulers (usually kings or queens) to enact the absolute political rule which contemporary political theory assigned to them. Thus, political control often lay in part or wholly in the hands of those who were not in theory the highest orders: notably the highest ranks of aristocracy. Another important divergence between theory and

practice resulted from the weakening of feudal relationships in the many towns of medieval Europe. In towns, people of all ranks could mix and engage in market-based exchange. Overseas trade flourished and a network of mercantile linkages existed across Europe (and beyond) from the very start of the feudal period. Thus wealth and status could be gained outside the regular structure of feudal society by traders and townspeople engaged in crafts production and specialist activities. To some extent the Church also operated independently of feudalism, forming another basis for contesting the idea of simple vertical 'lines' of ranked political and economic control in feudal Europe.

Many misconceptions about feudal societies can be found. The existence of money-based free-market exchanges, of economic, social and political advancement outside (and challenging) feudalism, and the strength and territoriality of the medieval European state are frequently underestimated or ignored by scholars discussing feudalism. Regional and chronological variation existed in feudal Europe, which undermines simplistic discussion of this as a period in which statehood was insignificant or lacked explicit formalization.

The date and circumstances of the origins of feudalism have been much debated. Recent studies have tended to suggest that it originated in the tenth century rather than earlier, along with many of its most characteristic landscape features. The extent to which societies other than those of medieval western Europe can be described as 'feudal' has also been hotly disputed. Candidates proposed for such a designation include the Byzantines, medieval and later eastern Europe and the Inca. The end of feudalism is also disputed. However, most historians would favour an earlier date (in the fifteenth or, at latest, sixteenth century) for the end of 'classic' western European medieval feudalism (and thus for the Middle Ages) than that often suggested by political scientists (namely, 1648).

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finance and information technology

The re-emergence of global finance is often attributed to innovations in information technology (IT). This seemingly plausible understanding is derived from the widely held idea that human progress is fundamentally a product of technical change. History, in this view, is out of our hands and we are not therefore responsible for the dislocating effects of economic change. The recent history of finance does not, however, support this account. The re-emergence of finance as a global phenomenon is a reflection primarily of politics and changes in policy, and not the effect of new technologies. After all, between the 1930s and the 1970s, when CAPITAL MOBILITY was restrained, information technologies such as the telegraph and telephone (which had made the pre-World War I era of international finance possible) were in wide use. The 1980s DEREGULATION of financial controls was not driven by the internet (which would not become ubiquitous until the mid-1990s) but by the advantage governments perceived in moving to

accommodate a more liberalized market-driven system.

Even if information technology did not create the deregulation of finance and its return as a global phenomenon, IT is crucial to an understanding of key contemporary developments in finance. The internet and other information technologies are central to the strategies of commercial banks that are seeking to secure a useful role for themselves in a world of DISINTERMEDIATION and SECURITIZATION. FINANCIAL INNOVATION is dependent on powerful and well-organized computing infrastructures. Some analysts claim IT is helping to create a new group of highly skilled individuals with the ability to circumnavigate big institutions, confident in their own judgements.

The impact of IT on financial institutions is, in the first instance, on transaction or 'back office' costs, speeding up the time it takes to complete trades and allowing parties to a transaction – indeed, whole markets – to go offshore and out of the reach of regulators. IT allows for increasingly complex transactions to be undertaken in large volumes in less and less time. Information – the fundamental variable in all economic exchange – can be delivered quicker, cheaper and in more depth than ever, improving the probability that markets will clear. What Phil Cerny terms the 'qualitative change' brought about by IT promises to mechanize many of the intellectual tasks currently undertaken by financial analysts (Cerny, 1997: 159). What enthusiasts for the productivity-enhancing effects of IT on finance need to demonstrate is the degree these now outweigh the traditional locational advantages that created PRINCIPAL FINANCIAL CENTRES (PFCs) like New York and the CITY OF LONDON (Sassen, 1999).

Although IT is most pervasive in the financial industry, it is not the primary variable behind that industry's growth since the 1970s. Public policy decisions have been more important. To date, the primary impact of IT has been in enabling the speeding up of transactions. The future potential impact of expert systems and artificial intelligence on the global

finance industry may be more significant than the quantitative effects so far experienced.

See also:

information society/economy

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TIMOTHY J. SINCLAIR

finance capital

The concept 'finance capital' finds its origins in HILFERDING's contribution to Marxist economic theory (see MARXIAN ECONOMICS). Building on Marxist analysis of the definition and role of bank capital, as contained in the third volume of *Capital* (Marx, 1992 [1894]), Hilferding develops the most exhaustive theoretical examination of the notion, in his *Finance Capital* (Hilferding, 1981 [1910]). This, in turn, serves as the basis for Lenin's study of imperialism.

In this context, finance capital is understood as that part of bank capital which is transformed into industrial capital through the increasing intervention of banks in the control of the productive sector. In other words, according to Hilferding's analysis, whenever the money capital deposited with the banking sector (both in the form of bank-owned and non-bank-owned capital) is used to finance the productive activity, it is called finance capital. In turn, bank capital can be converted into industrial capital in two ways. First, by simply

providing credit to an industrial enterprise, that is, by simply lending capital to the enterprise. Second, by acquiring shares in the enterprise, a technique that allows the banks to control the joint-stock company in the long term.

At this point it is necessary to clarify a number of concepts that are implied in the above definition of finance capital and which are strictly related to the theoretical tradition in which the definition is inserted.

In the Marxist theoretical paradigm, the development of capitalist industry produces a concentration of banking which, in turn, leads to an increased CARTELIZATION of industry. This happens because, on one side, the increasing credit-needs of a growing industrial sector call for a concentration of credit activity in the hands of a smaller number of banking enterprises; on the other side, the banking sector orientates its funding towards the most profitable productive enterprises, which are usually large-scale, thus further adding to the process of concentration. In this process, however, the productive sector becomes increasingly and structurally dependent on bank finances, which is to say that, with the evolution of the capitalist economy, bank capital necessarily becomes finance capital. Thus, the bank, which at the beginning of the capitalist process of accumulation was a simple intermediary, performing a simple money-dealing activity, becomes the co-owner (if not the only owner) of the productive sector. As Hilferding puts it, finance capital is the negation of the negations: bank capital, which was the negation of money-dealing (that is, user's capital), is itself negated by finance capital.

It is important to point out that in this theoretical context, the domination of the banks over industry is determined by the increasing participation of bank capital in the process of production, thus by the transformation of bank capital into finance capital. This, in turn, is the necessary consequence of the process of cartelization and concentration of both the productive and bank capital, which is brought about by the development of capitalism itself.

There is, summing up, an aura of painful inevitability in Hilferding's approach to the emergence and domination of finance capital in advanced capitalist economies.

From a sociological point of view, however, this process does not imply that the industrial magnates are subordinated to finance. It simply implies that, with the evolution of capitalism, the two social fractions tend to merge into a single class through personal connections. LENIN's definition of finance capital builds directly on Hilferding. In *Imperialism* (Lenin, 1996 [1916]), he defines finance capital as that 'capital controlled by banks and employed by industrialists'. However, Lenin is keen to point out that this definition is incomplete in so far as it is silent on one extremely important fact: the increase of concentration of production and of capital to such an extent that it leads (and has led) to MONOPOLY. According to Lenin's analysis, finance capital (concentrated in a few hands and exercising a virtual monopoly) 'exacts enormous and ever increasing profits from the floating of companies, issue of stocks, state loans, etc.' Thus, it tightens the grip of financial oligarchies and levies tributes on the whole of society for the benefit of monopolists. Then, once a monopoly is formed and controls thousands of millions, it inevitably penetrates into every sphere of public life, regardless of the form of government and what Lenin calls all other 'details'. Indeed, by overcoming the notion of concentration and substituting it with the notion of monopoly as the final stage in the development of capital concentration, Lenin is able to overcome the whole debate over the relation and possible clash of interests between bank and industrial capital.

Hilferding, on the other hand, has been often criticized for attributing too dominant a role to bank capital. More generally, it has often been claimed that Hilferding's analysis was catalysed by the experience of Germany and Austria and did not take into consideration the different relationship between banks and industry in other capitalist countries. The main issue at stake is exactly whether it is possible to consider the structural dependence

of industrial capital on the banks (which characterized the German and Austrian capitalist structure at the particular historical moment analysed by Hilferding) as a general characteristic of the evolution of capitalism.

Particularly revealing in this respect is the analysis of the relations between the industrial and banking sectors in the United Kingdom, which is at the heart of a long-lasting debate on the nature and characteristics of British capitalism and development. The term mostly used by the scholars to define the development of British capitalism and, consequently, to describe the present characteristics of its economic, political and social organization is that of 'exceptionalism'. Despite agreement among the majority of the authors over the recognition of the peculiar, 'exceptional' nature of British capitalism, the hypotheses proposed to explain this phenomenon as well as the very definition of British exceptionalism differ in a variety of ways. In the most widely accepted explanation, exceptionalism coincides with British traditionalism, and the persistence of aristocratic, pre-industrial elements in British polity is seen to have only a symbolic and legitimacy meaning. From this perspective, there is no doubt that Britain has become a truly capitalist, bourgeois society, but it is one to which the aristocratic and traditional elements have successfully adapted themselves.

However, there is also another fairly well established (but less widely accepted) interpretation of these developments, namely, a Gramscian interpretation rooted in PERRY ANDERSON's seminal work on the subject. According to this interpretation, traditionalism has remained the dominant force in modern British ideology. Moreover, traditionalism not only has a symbolic or legitimacy significance, but also a materially inhibitive impact on the economic performance of British capitalism itself, since it is based on the hegemony of specific fractions of British capital. For Anderson, the 'exceptionalism' of British society is due to the dual nature of British capitalism, that is, the separation of the financial fraction of capital from the industrial, and the dominance of the former over the

latter. This is reflected in the persistence of aristocratic, pre-industrial forms in the organization of civil and political society, as the British financial and banking elite is recognized as the carrier of pre-modern, aristocratic cultural and social values. On the other hand, the British capitalist structure is characterized also by the existence of the hegemonic position of the capitalist bloc as a whole as opposed to the non-hegemonic though self-conscious bloc of the working class. Here the concept of 'hegemony' is defined in Gramscian terms (see GRAMSCI, ANTONIO) as the 'dominance of one social bloc over another, not simply by means of force or wealth, but by a total social authority whose ultimate sanction and expression is a profound cultural supremacy'.

Up to this point, there seems to be no striking inconsistency between Hilferding's theory on the domination of bank capital over industrial capital and the hegemonic position of the British banking sector over British industry. Indeed, in this context, the CITY OF LONDON is not only a dominant economic and social actor but, together with its political referents (that is, the Treasury and the Bank of England), it is considered responsible for British economic decline from the second half of the nineteenth century. The crisis of British industry is in fact explained as the logical outcome of a long subordination of the needs of productive capital to the economic interests and preferences of the City.

However, the problem with the application of the Marxist definition of finance capital to British bank capital and, more particularly, to the City of London, arises in relation to the fact that there seems to be no structural dependence of the productive sector on the finances of the banking sector in British capitalism. In other words, notwithstanding the evident hegemonic position of the City of London in the British capitalist structure, there seems to be a structural separation of banking activity from productive activity. This is indeed one of the main characteristics of the Anglo-Saxon capitalist model as opposed to the German model.

At this stage it is important to clarify two

points which will help elucidate the extent to which it is possible to apply the Marxist concept of finance capital to describe the role and activity of the British financial and banking sector. First, the conceptualization of the City and, consequently, the explanation of Britain's pattern of economic development, and, second, the analysis of relations between the economy (City) and the state. The most important problem concerns the theoretical definition of the City and, consequently, the specification of the precise nature of its relationships with domestic industry. For many authors interested in the subject, the City is simply the centre of British finance capital, that is (in the Marxist definition provided above) the fusion of banking capital with large-scale productive capital. A number of objections are raised by other scholars against this conceptualization of the City and an alternative definition has been proposed, which puts much more emphasis on a clear identification of the City's economic activities.

At a preliminary stage, it is appropriate to distinguish between the different economic activities of commerce, banking and finance. The term 'commerce' may be taken to refer to the practice of buying and selling, or the promotion of the exchange of commodities, including money and securities. 'Banking' is defined as the acceptance of deposits and the extension of loans at a rate of interest. 'Finance', in its broader meaning, consists in the provision of money capital for other activities such as production, consumption, trade, state expenditure and so on. Whereas, clearly, many of the City's activities are 'financial' in the loosest sense (that is, they make money capital available for different uses by means of the markets), they also comprise many commercial practices. Thus, the roles of the City's houses as middlemen and brokers in the provision of finance overseas (and domestically for that matter) are best viewed as commercial practices, giving rise to services income. Indeed, the net overseas earnings of the City's financial institutions are mainly, if not exclusively, represented by services income, and banking, finance and business services

account for a substantial part of the British GDP. Moreover, one of the most distinctive and enduring features of the City's financial role is recognized in the almost complete absence of any direct involvement by its institutions in the means by which surplus value is created. Rather, the City's organizations have acted almost exclusively as intermediaries between investors and borrowers, and have been traditionally characterized by a marked organizational separation from any form of productive enterprise. This has not simply been a matter of an overseas orientation of British 'finance capital' and thus the explanation of British exceptionalism cannot be found only in its imperialist policies. In fact, the City's profits have not been primarily in the form of interest, but rather in the form of brokerage fees or commission, that is, commercial profit from the trading in various forms of investment capital. Further, as brokers or intermediaries in overseas stocks and bonds, as well as domestic ones, the City firms have not necessarily been interested in the successful long-term performance of the particular share issues in which they dealt. Rather, the reverse is true. One of the most frequent criticisms of the British capitalist model is exactly that of 'short-termism' – that is, the essentially speculative nature of the activities of the British banking sector, particularly in relation to the buying and selling of corporate shares. What is more, it is precisely the prevalent short-term attitude of British banks to the financing of productive activity that has been often blamed for the present crisis of British industry.

Thus, the City should not be simply defined as the locus of British finance capital, or in terms of the designation of its constituent companies, such as banks. It should instead be conceptualized as the institutional structure of short-term exchanges in commodities, securities, money and services. Consequently, its operators, merchant bankers, securities dealers, bill brokers and so on, are understood as intermediaries promoting exchange predominantly within financial and commercial systems, and in this sense they are wholesalers.

This definition permits one, on one hand, to

link the seemingly discrete activities of merchant banking, foreign-exchange dealing, bill broking, securities dealing and so on, and, on the other, to account for the City's uniqueness in the world. Indeed, the City's revival – brought about by the expansion of the various short-term money markets, such as the EURO-CURRENCY MARKET and other new parallel markets – cannot be readily explained by a theory of finance capital. Moreover, a more careful identification of the City's activities – such as, for instance, that carried out by SUSAN STRANGE (1971) – is not only essential for an understanding of its economic relationship with domestic industry, but also of links between the City and the state. These links have been the basis for the political reproduction of the City's conditions of existence and the related defeat of the various industrial strategies that have threatened them.

This leads to a second point related to the conceptualization of the City of London, namely, the City's continued dominance throughout the twentieth century in the face of its own economic difficulties and the consequent growth of industrial opposition. Britain's economic power and, with it, sterling's pre-eminence have declined. However, not only has the City survived, but it prospers as much as it ever did in the late nineteenth and early twentieth centuries. According to some authors, the implementation or maintenance of policies supported by the City, carried out by the state agencies (not necessarily media) of the Treasury and the Bank of England, is owed to the dominance of these institutions within the state system. Their power was not instrumentally related to their penetration by a fraction of bank capital, but was based on their political role as the real possessors and managers of the state's finances and was the product of a quite autonomous political struggle within the state during the nineteenth century. Moreover, the general coincidence of interests between the City, the Bank and the Treasury in relation to currency and free trade has not simply been the result of the City's hegemony. During the twentieth century, the Treasury and Bank have also favoured the

policies that the City has advocated because of their favourable impact on their own independent practices and institutional power. To support this view, it is worth relying on empirical evidence, which shows how the historical evolution of the City of London, of the Bank of England and of the Treasury was clearly interconnected. Thus, more than contrasting an 'instrumental' interpretation of the relation between state agencies and the economy with an 'independent' interpretation of the relation between state agencies and the economy, it might be more appropriate to speak about the socio-political relations between the City and its political referents as historically determined.

In conclusion, the analysis of the City of London and British bank capital casts some doubts on the possibility of applying indiscriminately the Marxist concept of finance capital to all advanced capitalist countries. Rather, the existence of different patterns of capitalist development, as well as of different economic structures, highlights the necessity of a careful historical and empirical investigation of the different relations between bank and industrial capital in different socioeconomic contexts. The adoption of a less deterministic approach, however, does not diminish the importance that the banking sector and, more generously, the financial sector have acquired in the globalized economy.

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financial crisis

Financial crises are characterized by large-scale defaults by both financial and non-financial enterprises, usually accompanied by falling incomes and prices in the economy as a whole. In principle, the implications of such crises can be confined to a single country. In fact, both financial and other forms of economic INTERDEPENDENCE mean that they are transmitted internationally: the phenomenon of 'CONTAGION'. The term 'financial crisis' has also been extended to cover a second class of events: BALANCE OF PAYMENTS and FOREIGN

EXCHANGE crises that are triggered by the withdrawal of foreign financing. These crises may or may not be accompanied by widespread distress in the financial and corporate sectors, although the Scandinavian banking crises of the early 1990s and the Asian financial crisis of 1997–8 (see ASIAN CRISIS) demonstrated how the two can compound one another. Finally, the term has been extended to a third phenomenon: fiscal crises or crises associated specifically with the market for government debt. These can also have wide-ranging international implications when government debt is held by foreign creditors.

Financial crises have occurred throughout modern economic history: the tulip mania in the Netherlands (1636), the South Sea Bubble (1720), the EAST INDIA COMPANY crisis (1772), the collapse of the railway boom in the United States (1846), the failure of Union General (1881) and Baring Brothers (1890), and the US banking panics of 1873, 1893 and 1907 are prominent examples. Black Thursday in October 1929, the failure of the Austrian Creditanstalt in 1931 and the ensuing worldwide banking collapse of the next two years were milestone events in the unfolding of the GREAT DEPRESSION.

The diffusion of Keynesian ideas (see KEYNESIAN ECONOMICS), the development of prudential REGULATION of financial systems and the rapid economic growth of the immediate post-war period appeared to dampen the propensity to financial crisis. Economists turned their attention away from the anatomy of crises and towards the more normal functioning of the BUSINESS CYCLE. Beginning in the late 1960s, however, the international financial system began to experience more financial crises, beginning with the currency crises of 1969–71 that triggered the collapse of the BRETTON WOODS SYSTEM. The 1980s and 1990s proved surprisingly crisis-prone. The developing country DEBT CRISIS of the 1980s, the banking crises of the early 1980s across a number of developed and developing countries, the US STOCK MARKET crash of 1987, the European EXCHANGE RATE crisis of 1992 and the Asian financial crisis of 1997–8 all posed

major international policy challenges, although many of these crises were contained and did not all develop into full-blown crises of the real economy.

The dramatic increase in cross-border lending has also increased the international policy stakes from the failure of individual financial institutions. The failure in 1974 of Herstatt, a relatively small German bank, created substantial problems in interbank markets. Since that time, threats to the payments system posed by the failure of individual financial institutions have periodically triggered intervention or regulatory cooperation among the advanced industrial states, most recently in the case of the Long Term Capital Management hedge fund in 1998.

The propensity of financial markets to instability has produced a number of efforts to generate a unified model of financial crises. Marxist theorists (see MARXISM–LENINISM) have long stressed the propensity of capitalist economies to crisis. However, this view is also a central staple of Keynesian thinkers such as HYMAN MINSKY and CHARLES KINDLEBERGER. Kindleberger's model outlines the 'canonical' crisis consisting of 'mania, panic and crash' stages. In the first period, both asset prices and confidence about the future increase, driven (for example) by a favourable demographic or technological change. Firms and households increase their leverage, liquidity increases, the demand for goods and services goes up and the economy expands. Psychological factors also operate. On the assumption that good times will continue, rising asset prices generate more rather than less demand for stocks and other assets (such as real estate), generating the possibility of asset-market inflation or 'bubbles'.

In the second period, some event (either economic or political) generates a revision of expectations. Insiders decide to take profits, new investment stops and 'rational panic' sets in. Each investor knows that rushing to sell will only compound the collapse of asset prices, but it is nonetheless rational to do so to avoid being left 'holding the bag'.

During the crash phase, the effects of a

sharp drop in asset prices are transmitted throughout the financial sector and beyond it into the real economy. For example, a bank lending to real estate or stock market SPECULATION appears vulnerable to failure, triggering a contraction of credit in the interbank market and runs on other healthy banks. As liquidity dries up, corporate clients are unable to raise funds or borrow and real investment dries up. Bankruptcies increase. Concerned about their economic security, households stop spending and aggregate demand falls. The result is recession and falling prices.

The model, as outlined here, purposefully omits the role of government, which can make things worse by, for example, responding to panics with inappropriate monetary policies. Since the Great Depression, however, governments have developed a range of instruments to counter the dynamic just outlined. These include not only countercyclical macro-economic policy (see MACRO-ECONOMIC POLICIES), but also tools to prevent or dampen financial panics and what is known as 'systemic risk': threats not only to individual financial institutions but to the entire payments system. The most important of these policies is the central bank's role as LENDER OF LAST RESORT – or provider of liquidity during crises. But the government also limits excessive risk-taking through prudential regulation, such as CAPITAL ADEQUACY STANDARDS, and reduces the threat of bank runs through deposit insurance schemes.

The central controversy surrounding the government's intervention in financial markets is the problem of MORAL HAZARD – the possibility that policy measures designed to counter systemic risk will simultaneously have the effect of encouraging excessive risk by promising government (and ultimately taxpayer) support in the case of widespread distress. The problem of moral hazard can never be eliminated in its entirety. But the problem can be reduced through a number of means, such as requiring banks rather than taxpayers to pay for insurance and by signalling in advance that financial support for ailing institutions will be granted only when share-

holder equity is written down to zero and management is displaced. Such mechanisms do not eliminate the social or fiscal cost of financial crises, but they do serve to reduce the incentives to excessive risk-taking.

When we move beyond this very general picture of a financial crisis, we discover in fact a variety of different ways in which they might unfold, as well as substantial controversy over their origins in any particular case. For example, the Kindleberger model emphasizes the inherent tendency of financial markets to generate speculative excesses and bubbles, but crises may also be triggered by developments in the real economy. Incomes decline for reasons other than financial crises – for example, as a result of TERMS OF TRADE shocks, devaluation or WAR, and when these shocks are severe enough they can spill over from the real economy into the financial system. In the 1980s, in the United States, virtually all of the banks in Texas failed as a result of falling oil prices. During the debt crisis of the 1980s, developing country debtors argued similarly that exogenous shocks were responsible for their debt problems, including rising oil prices and interest rates, slowed growth in the ORGANISATION FOR ECONOMIC CO-OPERATION AND DEVELOPMENT (OECD) countries and declining terms of trade.

The creditor countries, by contrast, tended to interpret the debt crises of the 1980s as the result of misguided macro-economic policies. Balance of payments crises – currency depreciation, loss of reserves and collapse of a pegged exchange rate – can result when the expansion of domestic credit by the central bank is not consistent with the maintenance of a FIXED EXCHANGE RATE. Such monetary expansion was often the result of financing large fiscal deficits: this was the case in Latin America in the 1980s and during the Russian crisis of 1998. The expansionary monetary policy has as its counterpart INFLATION, increasing demand for foreign assets ('CAPITAL FLIGHT') and a decline in reserves. At some point, the central bank's reserves are exhausted and the economy is pushed towards a floating rate.

The Asian financial crisis of 1997–8 was clearly not a crisis of this sort: fiscal policy in the region was generally very conservative. As a result, a number of analysts focused on a very different model of crisis – one in which either speculative attacks or financial panic play a central role. In the policy-induced crisis story outlined above, collapse comes when the central bank runs out of reserves. However, informed speculators do not simply wait for this event to occur: they attempt to anticipate it in order to avoid large capital losses. They do so precisely by withdrawing funds (or ‘attacking’ the currency), which induces panic and accelerates the collapse. One condition under which such attacks are particularly likely is when short-term debts exceed short-term assets: studies of a number of financial crises emphasize the accumulation of short-term debt as an important predictor.

The Asian financial crises also demonstrated how external and domestic financial crises can be linked. In both Korea and Thailand, LIBERALIZATION of the capital account allowed private domestic financial institutions to borrow in international financial markets. Because of the costs of HEDGING and the government’s commitment to a fixed rate, this borrowing was not hedged against possible exchange rate movements. When the inevitable devaluations arrived, both banks and corporates saw sharp increases in their debt-servicing costs. A vicious cycle ensued. Banks limited lending and sought to call in loans to meet increased debt-servicing costs. This led to a contraction of investment, slowed economic growth and more corporate distress, which was reflected in the deteriorating balance sheets of the banks. At the depth of the crisis in Indonesia, 70 per cent of all bank loans were non-performing.

The financial crises of the 1980s and 1990s could also be attributed in part to contagion. Financial crises might spread from one market to another through a variety of mechanisms. Speculative attacks and devaluation in one country might lead to a re-evaluation of the stability of other similarly positioned countries. Increasing financial interdependence can also

be a source of contagion. When a crisis occurs in one market, portfolio managers will seek to reduce similar risks by selling assets; those sales can contribute to the spread of financial panic. Such a phenomenon was visible in the 1998 crisis in Russia, which was quickly followed by strong pressures against Brazil and other emerging markets as fund managers redeemed Brazilian investments to cover Russian losses.

Financial crises raise two political and policy issues: what to do about them when they break and how to prevent them from occurring in the first place. The resolution of domestic financial crises is extraordinarily costly and almost always involves the commitment of some public funds. This may occur through payouts on depositor insurance, through the purchase of non-performing loans, or through public recapitalization of banks. In a number of financial crises (for example, Chile in 1982), the government effectively ended up owning large portions of the financial system. The politics of crisis resolution is primarily a politics of loss allocation. Given that public money is being spent and labour implicitly pays through the effect of the crisis on the real economy, losses should also be imposed on managers, shareholders and large creditors, both domestic and foreign. However, these groups are often able to avoid bearing the costs of crisis.

The resolution of international financial crises also involves public money in the form of INTERNATIONAL MONETARY FUND (IMF) support. In major financial crises, such as the debt crises of the 1980s, the MEXICAN PESO CRISIS of 1994–5, the Asian financial crisis of 1997–8 and the Russian crisis of 1998, IMF money proved inadequate and creditor governments also contributed. In the Asian financial crisis, this support became highly controversial because the restrictive monetary and fiscal policies designed to stabilize the exchange rate simultaneously had the effect of substantially deepening *domestic* financial distress. The expansion of CONDITIONALITY has also proven controversial: IMF standby agreements initially targeted macro-economic and exchange-rate policy. Beginning in the 1980s, condition-

ality expanded and during the Asian financial crisis came to include domestic financial restructuring as well.

The Mexican peso crisis of 1994-5 triggered a search for preventative mechanisms and negotiations ensued over what came to be called the 'NEW INTERNATIONAL FINANCIAL ARCHITECTURE'. One objective of this new financial architecture was to increase the transparency in international financial markets by expanding and codifying the information central banks provided to the market about such key variables as short-term debt. Enhanced surveillance by the IMF was to assist in providing more timely information to the markets. A second component of the debate centred on various regulatory reforms. Advanced industrial states did coordinate and harmonize policy with respect to capital adequacy standards in the 1988 BASLE CONVENTION, and in the late 1990s efforts continued to deepen this initial agreement and extend it to other areas of regulatory practice. Emerging markets came under particular pressure to strengthen prudential regulation.

A third component of the new financial architecture is the debate over how to include private creditors more systematically. International workouts of both private and SOVEREIGN DEBT have typically taken place in an *ad hoc* case-by-case fashion. Moreover, international norms have typically favoured creditors in assuming full repayment, even though creditors typically end up absorbing some losses during severe crises. A variety of proposals have been advanced for incorporating private creditors in the process, from the way bond contracts are written to facilitate workouts to the creation of an international bankruptcy procedure.

A final controversy triggered by the crises of the 1980s and 1990s was whether the increase in CAPITAL MOBILITY was itself to blame for crises and should thus be slowed. A number of emerging markets experimented with various forms of selective capital controls, including Brazil, Chile and Malaysia. Other economies, such as China, India and Taiwan, appeared to weather international crises precisely because they had never liberalized their capital ac-

counts. The advanced industrial states continued to resist the solution of capital controls, which was seen as disadvantageous to the interests of their own multinational banks and financial firms. However, the crises provided strong support for the idea that capital account liberalization should be cautious and coupled with strong prudential regulation.

Despite calls for radical reform of the system (from the abolition of the IMF to the creation of altogether new institutions), the post-crisis reforms appear relatively modest, focused primarily on improving transparency and the quality of regulation.

See also:

bubbles; financial panics and crises

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financial innovation

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STEPHAN HAGGARD

financial innovation

Financial innovation encompasses the introduction of new products, markets and processes in the financial sector. Financial product innovation can result from genuine development of an instrument as well as from splitting or recombining of the features (for example, credit risks or interest and currency features) of existing products. Financial product innovation can be segmented into financing instruments (for example, floating rate notes, stripped bonds), hedging instruments (for example, financial futures, options, financial swaps) and specific financial services (for example, portfolio management). Product innovation often requires financial market innovation, as there has to be a corresponding market to introduce the newly designed instrument. Financial process innovation relates to technologically driven innovation, like electronic banking, and new developments in processing and financing techniques, such as securization and pooling.

Causes for the development of financial innovation are liberalization and globalization in the financial sector, as well as volatile interest and exchange rates. Furthermore, financial innovation is often motivated by the desire to bypass state regulations, like interest-rate ceilings.

From a macro-economic perspective, financial innovation is supposed to contribute to a more efficient control of saving and investment by improving capital and risk allocation, lowering transaction costs, increasing liquidity on capital markets and by improving information efficiency. However, it is often noted that financial innovation does not contain sufficient risk-analysis and -control, and causes inflation

of trade volumes in financial markets. It also involves the danger of disturbing monetary policy. For example, the money-supply definition can be undermined by the substitution of sight deposits by financial innovation. Furthermore, financial innovation can limit the effectiveness of monetary policy measures. An example would be an intended increase of interest rates which gets weakened by loans and bonds with variable interest rates.

See also:

financial instruments

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GABRIELE MEINERT

financial institutions

Financial institutions include both financial markets and financial services firms. Financial markets facilitate the exchange of non-tangible assets. Financial markets include those for loans, SECURITIES, currencies, FUTURES, DERIVATIVES and more specialized products. They operate both domestically and globally. Global financial markets remain open twenty-four hours a day, with major financial centres operating in cities including New York, London and Tokyo. The ability of financial institutions to allocate resources among borrowers and savers is critical for economic health and stability. They also may contribute to the economic strength of their home countries and customers by financing 'real' sector development through savings and investment.

Financial services firms gather funds from the public and use them to purchase assets including loans and bonds. Numerous types of private financial firms operate in global markets such as commercial banks, INVESTMENT BANKS (also known as merchant banks), brokerage houses, insurance companies and pension funds. Traditionally, financial services firms have been distinguished by the nature of the assets they purchase and claims they issue. Thus, commercial banks accept deposits and make loans while insurance company claims include the policies they sell. In recent years, however, the lines between different types of firms have blurred as they have sought new profits and products capable of meeting the needs of increasingly sophisticated consumers. Increasingly there is a tendency to universal banking in which single financial institutions offer a variety of services and financial products. Many financial institutions have also developed profit centres outside their original line of business; banks, for example, provide investment advice, sell insurance and charge fees for numerous services. Moreover, non-financial institutions have made inroads into markets that were once the preserve of financial institutions. Captive financing operations such as the General Motors Acceptance Corporation (GMAC), which provides loans to purchasers of General Motors products have gained domestic and global market shares. Financial activities by non-financial institutions have complicated the task of regulators and contributed to the already highly competitive nature of financial markets.

Global financial markets have grown exponentially since World War II. The sources of this growth are controversial but most experts agree that it resulted from some combination of 'push' and 'pull' factors operating on financial services firms. Financial firms have been pushed by competition and regulatory restraints to seek profits outside domestic markets. They were also pulled by the expansion of trade and transnational corporations.

Financial firms operate in among the most highly regulated domestic markets, but also in a relatively unregulated international environ-

ment, especially in so-called 'offshore' banking centres and in eurocurrency markets (see EURO CURRENCY MARKETS; OFFSHORE FINANCE). Recent efforts to harmonize the regulation of financial institutions have had significant but still limited successes. International committees operating under the auspices of the BANK FOR INTERNATIONAL SETTLEMENTS (BIS) have harmonized bank capital adequacy standards, while private regulatory agencies are bringing some order to international securities markets. In other areas, however, progress is less visible. Financial crisis management, for example, remains largely *ad hoc* and highly dependent on major actors such as the United States. Public or private REGULATION of financial institutions is critical for global economic stability because such institutions serve as the transmission belts for international economic maladies including inflation, currency runs and capital flight.

PETER DOMBROWSKI

financial instruments

Financial instruments are the products traded in financial markets. Indeed, it is the existence of a multitude of different financial instruments which allows for the existence of many different financial markets.

A financial instrument can be viewed as a composite product having multiple features, such as rates of return, credit risk, market risk (namely, interest-rate risk, exchange-rate risk and inflation risk), maturity and liquidity, among others. These features represent the basis for distinguishing different broad categories of instruments.

For example, a very common way to classify financial instruments is according to their maturity – that is, the length of time which has to elapse before the claim expires. According to this criterion, it is possible to distinguish between short-term financial instruments (like Treasury bills or bank deposits) which are commonly traded in the money markets, and long-term ones (like SECURITIES) which are

financial integration

traded in the CAPITAL MARKETS. It is also possible to distinguish instruments which are issued at fixed interest rates (the typical example being BONDS) from those whose yield varies according to the conditions of the market (such as shares or bank deposits). Alternatively, it is possible to divide financial instruments into those which can be traded directly between holders (like securities) and those which cannot (like bank deposits). Finally it is possible to make a distinction between traditional financial instruments (such as bonds or stock) and FINANCIAL INNOVATIONS. A financial innovation is a new instrument which enhances desirable features and reduces undesirable ones for market participants. The spread of new financial instruments gave rise to the establishment of new financial markets. Some examples of financial innovations are swaps, options and futures (see FUTURES; OPTIONS, FINANCIAL; SWAPS), which are traded in the DERIVATIVES markets, and euro-assets (both eurocurrencies and euro-bonds), which are exchanged in the EUROMARKETS.

See also:

financial innovation

L.S. TALANI

financial integration

One of the most debated issues in international political economy (IPE) is the problem of international INTEGRATION and the extent to which it can impinge on the socioeconomic organization of the world. The process of financial integration refers to the increasing INTERDEPENDENCE of financial markets which, in turn, is the result of a variety of factors. Some of these factors are independent of any political intervention, while others may easily be connected to the existence of political will at both national and international level.

Among the first groups of factors, the most obvious is the evolution of technological

innovation and its impact on the speed at which financial transactions may be effected all over the world, as well as the ease with which capital can be moved from the periphery to the centre of the world and vice-versa. Partly connected to the technological factor is the unprecedented increase in the size of the markets themselves, as well as in the amount of people involved in the running of the financial system in an increased number of financial centres located all over the world.

However, one of the most important developments towards increasing the degree of integration and interdependence of financial markets is the development and spread of FINANCIAL INSTRUMENTS and FINANCIAL INNOVATION. Their overall impact on both international and national financial organizations is an increasingly debated issue. By enhancing desirable features and reducing undesirable ones for market participants, financial innovations are opening up financial markets to actors who would otherwise remain outside. Typical of financial innovations are DERIVATIVES (see FUTURES; OPTIONS, FINANCIAL; SWAPS), whose function is originally that of reducing the risk connected to other financial transactions. Eventually, however, their proliferation in the international financial system has had relevant consequences on the capacity of the states themselves to implement an independent monetary policy (see MONETARY POLICIES).

Indeed, the widespread use of derivatives has had an impact on both the transmission mechanism of monetary policy and on the ability of monetary authorities to control monetary aggregates. One important consequence of the diffusion of financial innovations, and derivatives in particular, is that capital flows between national markets have become increasingly sensitive to variations in interest-rate differentials and exchange rates (see EXCHANGE RATE). The progressive elimination of capital controls and other deregulatory moves initially gave impetus to this trend. However, the increasingly widespread use of new instruments, such as the currency swap, has greatly contributed to the emergence

of this phenomenon, as borrowers and lenders have gained progressively easier access to a wide range of close substitute forms of CREDIT. The result has been that national financial markets have become more closely tied together, with the consequence that disturbances in any one national financial market are more rapidly transmitted to other markets.

The implications for monetary policy of a high degree of substitutability between international assets must be assessed, carrying the following considerations into the analysis: first, when capital is immobile changes in monetary policy are transmitted to the economy primarily through changes in INTEREST RATES; second, when capital is mobile internationally, changes in monetary policy have their effect on the economy through induced changes in interest rates and the EXCHANGE RATE; finally, the relative importance of the exchange-rate channel is enhanced at the expense of the interest-rate channel as the degree of international CAPITAL MOBILITY rises.

However, conclusions about the impact of financial integration on national monetary policy also depend crucially on other aspects of the economy. These are, for example, the degree of flexibility of prices and wages in the short run, how expectations about the future path of the exchange rate are formed and how firmly these expectations are held. In practice, the freedom to conduct an independent policy has declined particularly where and when expectations about prices and exchange rates are highly volatile, and hence a case has been made for strengthening existing mechanisms of multilateral surveillance devoted to pursuing a stability-oriented policy. Moreover, financial innovation and structural change in financial markets has also adversely affected the operational usefulness of targeted aggregates. The proliferation of financial instruments, which combine the liquidity characteristics of traditional transaction-type instruments with a market-related rate of return, has required frequent redefinition of the narrower aggregates in Canada, the United Kingdom and the United States.

Finally, the demand for MONEY, however

defined, appears to have become unstable in some countries as a consequence of the process of innovation and STRUCTURAL CHANGE. As a result of the increased tendency to pay market-related rates of interest on many of the key components of the aggregates, the negative relationship between the demand for the aggregate and the level of interest rates under the direct control of the central bank has been reduced.

If the identification of the role of socio-economic actors in the shaping of this new international financial system is considered, one of the most significant contributing factors to this phenomenon is the broad process of DEREGULATION in national financial markets. This has severely limited the possibility of nationally elected representatives exerting any form of control on the development of financial markets, as well as multiplying the number of actors effectively involved in the international financial business by permitting NON-BANKS to compete more effectively with banks. It is still a matter of discussion whether the latest developments in the international financial system, often referred to as the realization of financial GLOBALIZATION, have increased the possibility of devising international financial cooperation or, on the contrary, encouraged the evolution of the modern capitalist economy into a game of chance.

See also:

casino capitalism; globalization; neo-liberalism

L.S. TALANI

financial panics and crises

A financial crisis typically consummates a period of irrational SPECULATION, in the wake of monetary/credit expansion during a structural stagnation (or even decline) in underlying economic growth rates. Starting with the 1720 South Sea Company Bubble, panics occurred in financial, commodity or property markets in 1763, 1772, 1793, 1797, 1799 and 1810. Such

panics reflected relatively immature markets, underdeveloped institutions, the uneven expansion of financial systems, the gullibility of investors and systemic vulnerability to emotion. Wars and geopolitical conflict were often catalysts. The Bank of England and City of Amsterdam performed LENDER OF LAST RESORT functions.

More disturbingly, the past two centuries of world capitalism were punctuated by the 1815–48, 1873–96, 1917–48 and 1974–99 episodes of stagnation, speculation and crashes. Such periodic cycles (or long waves) suggest that a crescendo of financial turbulence may contribute to economic catharsis and renewed capital accumulation (KARL MARX (1969 [1905–10]) described ‘violent eruptions ... forcible solutions of the existing contradictions which for a time restore the disturbed equilibrium’). Yet discrete crashes are sometimes insufficient to restore conditions for recovery, generating instead ‘payment-freeze’ which in turn makes commerce or investment very difficult to finance in subsequent years. (Thus the last three cycles were interrupted by severe financial panics – 1873, 1882, 1890, 1893; 1920, 1929, 1931; and various 1980s–90s crises – which did not immediately rejuvenate growth.)

Even where recovery follows, the panics cause enormous financial, social and ecological harm, often to firms, workers or entire societies which were innocent of speculation. Contemporary speculator George Soros concedes that financial markets ‘move in a herd-like fashion in both directions. The excess always begins with overexpansion, and the correction is always associated with pain’ (1998). Given the late-1990s role of the Bretton Woods Institutions and New York Federal Reserve in bailing out emerging-market investors (see BRETTON WOODS SYSTEM; FEDERAL RESERVE SYSTEM), the asymmetric liability (or MORAL HAZARD) for the enormous costs associated with financial panic was one important reason for the challenge to WASHINGTON CONSENSUS economic policy, by even World Bank economist Joseph Stiglitz (1998a, 1998b).

The most recent speculative bubbles and panics – to some extent offset by limited bail-

outs, but generally destroying a third or more of the value of financial assets – included the dollar crash (1970s), gold and silver turbulence (1970s–80s), Third World DEBT CRISIS (1980s), farmland collapse (1980s), energy finance shocks (mid-1980s), crashes of international stock (1987) and property (1991–3) markets, and the long fall (from 1973–99) in non-petroleum commodity prices and related securities. Emerging markets offered spectacular late-1990s examples of financial panic, including Mexico (early 1995), South Africa (early 1996 and mid-1998), South-East Asia (1997–8), South Korea (early 1998), Russia (periodic, but especially mid-1998) and Brazil and Ecuador (early 1999). Other examples of investment gambles gone sour included derivatives speculation, exotic stock-market positions and bad bets on currency, commodity and interest-rate options, futures and swaps, with specific victims covering enormous losses: Long-Term Capital Management (\$3.5 billion in 1998), Sumitomo/London Metal Exchange (£1.6 billion in 1996), I.G. Metallgesellschaft (\$2.2 billion in 1994), Kashima Oil (\$1.57 billion in 1994), Orange County, California (\$1.5 billion in 1994), Barings Bank (£900 million in 1995), the Belgian government (\$1 billion in 1997) and Union Bank of Switzerland (\$690 million in 1998).

See also:

financial crisis

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PATRICK BOND

financial regulation

REGULATION has been particularly important in financial markets because of the intangible nature of financial instruments and the interdependence of financial firms. Fraud, BUBBLES, panics, contagion, excessive risk-taking and collapse have often spread through financial systems and can have severe consequences for the economy as a whole because of the reliance of other sectors on financial flows.

With the LIBERALIZATION and GLOBALIZATION of finance, some regulations – especially those restricting cross-border financial flows and those maintaining separations between different financial industries (banking, securities, trusts and insurance, for example) or between non-financial and financial firms – have been dramatically reduced across the world. Other regulations, including prohibitions against insider trading, CAPITAL ADEQUACY STANDARDS for banks and codes of conduct for securities firms have been developed and strengthened. Both trends reflect the general reworking of financial regulation in order to foster and support the expansion of global financial markets.

Technological developments as well as the anarchic nature of the states system have posed challenges for state regulators: there is a tendency for competition, exacerbated by the ease with which financial assets can be moved across borders, to impose downward pressures on regulation, which can be seen as an unwanted cost by markets. Nevertheless, international political economy scholars have shown that states display more capacity for control and initiative than is often realized (see EUROMARKETS), and that cooperative efforts

such as the BASLE COMMITTEE ON BANK SUPERVISION's capital adequacy regulations, are a sign of some strengthening of regulatory capacity at the global level.

See also:

capital, controls on; capital, internationalization of; capital markets; capital mobility; deregulation; eurocurrency market; Federal Deposit Insurance; financial integration; financial panics and crises; International Federation of Stock Exchanges; International Organization of Securities Commissions; International Securities Markets Association; non-banks; off-balance sheet instruments; securities firms

TONY PORTER

financial structure

The financial structure identified by SUSAN STRANGE has two inseparable aspects: the way CREDIT is created in the global economy, and the system which determines currencies' exchange rates (see EXCHANGE RATE). Each involves a balance between authority and markets. While there has been a move from state authority towards financial markets, this was not inevitable but the result of state actions and STRUCTURAL POWER.

In the global economy it is not money that is invested but credit, and credit can be created. The ability to create credit for INVESTMENT reflects the structural power of certain states' banking industry. Additionally, banks' ability to control the funds required for economic DEVELOPMENT reinforces their position in the financial structure. State authority is mobilized through the INTERNATIONAL MONETARY FUND (IMF) and WORLD BANK, while also enforcing MONEY MARKET transactions and establishing legal currency units. While a state continues to be able to control the credit-providers and command such credit as it needs on favourable terms, it enjoys some measure of power in the financial structure.

First World

Exchange rates are increasingly determined by the international money markets. Money market reactions to government ECONOMIC POLICY therefore impact on the domestic economy through shifts in international purchasing power and through their influence over the perception of acceptable policies. The role of non-state actors in assessing the credit-worthiness of states in this regard reflects the diffused pattern of structural power over finance. The role of information and economic perceptions in the financial markets suggests a major link with power in the KNOWLEDGE STRUCTURE.

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CHRISTOPHER MAY

First World

Historically, the term 'First World' is a product of the COLD WAR period when it was used to express the antagonism between the capitalist West and the socialist East. The First World is constituted of all advanced industrialized countries, the SECOND WORLD embraced the Soviet bloc and the THIRD WORLD is made up of all underdeveloped and developing countries. In addition, the United Nations (UN) have introduced the term FOURTH WORLD, which includes all countries with an exceptionally small annual per capita income.

The First World manifests itself in various military and economic organizations. As a military alliance in the Cold War era, the NORTH ATLANTIC TREATY ORGANIZATION (NATO) was established among the First

World countries to block the Soviet military threat in Europe. The ORGANISATION FOR ECONOMIC CO-OPERATION AND DEVELOPMENT (OECD), the INTERNATIONAL MONETARY FUND (IMF) and the WORLD BANK are examples of economic organizations and institutions of the First World aimed at promoting economic growth, free trade and the expansion and improvement of western economic aid to developing countries.

In the 1970s, the First World was challenged by Third World countries, who were dissatisfied with their political and economic influence in the international arena. They demanded a NEW INTERNATIONAL ECONOMIC ORDER (NIEO) that implied increased financial aid, transfers of technology and a greater share of decision-making power in global economic institutions. Since the break-up of the Soviet Union, the West/East distinction in First and Second World has become superfluous. However, the term Third World is still prominently used to describe the economically disadvantaged position of developing countries in comparison with the First World.

MEHDI PARVIZI AMINEH

fiscal crisis

'Fiscal crisis' literally means the inability of a government to fund necessary and/or obligated expenditures. It is a shortage of tax revenues to finance a desired level of public expenditure. Theories of fiscal crisis therefore usually have two parts: (1) a mechanism driving the expansion of government expenditures and (2) forces that tend to suppress the state's ability to increase revenues in line with increased financial responsibilities.

Most of the academic attempts to explain the tendency of governments to encounter fiscal crisis focus on (1) above, with (2) often discussed as more of an afterthought. This research has also largely dealt with the advanced industrial states, with little attention given to the tendency for developing or

transition countries to also encounter mounting fiscal stress and crisis.

Beginning in the 1970s, public choice economists such as James Buchanan sought to show that public spending and public bureaucracies grow to an excessive and inefficient scale (see PUBLIC CHOICE (PC) THEORY). This school of thought cites systematic biases in the interests of politicians, bureaucrats and voter coalitions that favour government growth. Similarly, students of government REGULATION such as George Stigler identified interest-group regimes that instigate and preserve inefficient regulatory practices. Here the direct stakeholders – principally the industries benefiting from regulation – allied themselves to thwart the interests of the unorganized public in regulatory reform.

Several theories pointed to gradual evolutionary tendencies at work enlarging government. An old argument, dating from the nineteenth century and identified with Adolph Wagner, held that the externality problems created by economic growth, among other causes, produce a demand for more public services and higher public spending. A more recent thesis, put forward by William Baumol, contended that a shift in the public–private balance inevitably results from slower productivity growth in services than in manufacturing. Since government primarily produces services, its productivity lags behind the private sector, and it has to draw a growing share of national income to pay wage levels that match manufacturing.

From yet another quarter – the theory of post-industrial society (see POST-INDUSTRIALISM) – came a related set of reasons to anticipate further growth of government in the advanced Western societies: government would grow because its ‘businesses’, such as education, research and health-care, are growth sectors in post-industrial societies. Post-industrial societies depend on high levels of investment in intellectual and human capital, which only government can adequately provide. Furthermore, consumers with rising discretionary incomes demand more from government.

A rising level of public services and public spending was to be expected.

Other branches of social analysis saw a larger role for the state in managing endemic crises of authority and coordination. In the 1970s, some saw a trend towards neo-corporatist arrangements, with closer state supervision and integration of interest group organizations and a heightened level of economic management, including concerted incomes policies.

The economic problems of the 1970s, in this view, were leading towards greater interpenetration of state and society, not any withdrawal by the state. The omnipresence of the state in structuring society suggested to yet another school, critical legal studies, that the distinction between public and private had become meaningless. Therefore, no aspect of society was really beyond state intervention or should be considered off-limits.

These approaches, while providing compelling insights into the reasons for expanded government, do not really contend with the revenue side of the fiscal crisis. In contrast, several radical and Marxist writers have developed frameworks with an interlining of revenue and expenditure functions in a manner that produces fiscal stress and crisis. To these writers, there is a built-in tendency for modern fiscal systems to head for crisis, as there are increasing demands for egalitarianism and more public services not matched by a desire to pay more in taxation. When there is a concern with the disincentive and allocative effects of higher rates of tax, it is difficult to raise extra tax revenue, making a fiscal crisis more probable.

Radicals and Marxists usually start from the perspective that capitalist societies require increased state intervention to control their internal contradictions and crises. One variant of this position, the theory of ‘corporate liberalism’ popular among the New Left, suggested that higher social expenditure and other liberal policies are merely a means of rationalizing the capitalist order and controlling the oppressed. Programmes that seemed to represent concessions to the poor or to

fiscal policy

protesting groups were really enacted at the behest of far-sighted corporate leaders. Some Marxists regarded such 'instrumental' theories as too simplistic, arguing instead that the sources of state intervention lay in the 'structural' demands of the system.

In one prominent neo-Marxist account, *The Fiscal Crisis of the State* (1973), James O'Connor suggested that the capitalist state faces two imperatives – capital accumulation and legitimization – that lead it into difficulty. In the interests of accumulation and legitimacy, the state socializes various costs of production, but it leaves capitalists to appropriate the profits – hence, allegedly, the fiscal crisis. But rather than suggest that the state might cut back its commitments, O'Connor thought a likely response would be a further extension of government with the rise of a new 'social-industrial' complex.

It should be noted that literature on the fiscal crisis of the state hit a zenith in the 1970s and 1980s. In the 1990s, with declining defence expenditures and balanced budgets, the literature has shifted more to an assessment of the problems associated with the dismantling of the welfare state and 'solving' the problems of social security.

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ROBERT LOONEY

fiscal policy

The term 'fiscal policy' is the technical term used to describe the policies of states on taxation and allied measures. Fiscal policy has two broad objectives: (1) to ensure a sustainable balance between governmental income and expenditure; (2) to influence the general level of economic activity within the national economy. It is also possible to use

taxation as a mechanism for economic redistribution.

Recent debates have revived the doctrine of a 'balanced budget' and reinvigorated scepticism about Keynesian macro-economic management (see KEYNESIAN ECONOMICS), with doubts being raised about the effects of such management on longer-term economic growth and shorter-term economic stability.

See also:

taxation, indirect; taxation, progressive; taxation, regressive

R.J. BARRY JONES

fixed exchange rates

Under a fixed exchange-rate system, exchange rates are set at a predetermined level. They are not permitted to fluctuate freely on the market, but are fixed by governments (or central banks). As a result, fixed exchange rates cannot respond to daily changes in demand and supply on the foreign exchange market. A clear example of a fixed exchange-rate regime is the GOLD STANDARD, that operated for a large part of the nineteenth and twentieth centuries.

Specific features of a gold standard are:

- 1 The government fixes the exchange value of its currency in terms of gold by fixing the price of gold. The (fixed) price of gold in terms of the national currency is called the 'par value' of gold.
- 2 The government is committed to maintain convertibility of the national currency into gold. Thus, the government (or the central bank) will on demand buy and sell unlimited quantities of gold at the par value. This guarantees that the degree of fluctuation of the currency is limited to the costs of shipping gold.
- 3 The government holds gold of value at least equal to the outstanding stock of the national currency. This policy of 'gold backing' implies that the government creates

money only by buying gold from the public and destroys money only by selling gold to the public.

Assume that the United States and the euro zone are on the gold standard. Since gold is the common denominator in terms of which the dollar and the euro are fixed, it also serves to maintain a fixed exchange ratio between the two currencies. A par value of 260 euros per ounce of gold in the euro zone and of \$300 in the United States implies a euro/dollar exchange rate of \$0.87 (260/300). The exchange rate calculated from the relative price of gold in the United States and the euro zone is called the 'gold parity'. The gold standard works automatically in that the exchange rate remains at the gold parity level while convertibility is maintained.

If the gold price is predetermined, it cannot be expected to clear the market. The supply of gold can exceed demand at the fixed price. Conversely, the demand for gold can exceed supply at the predetermined price. If supply exceeds demand the government (or the central bank) has to intervene by buying up the excess supply. In such a situation, the government adds the purchased quantity of gold to its reserves. It retains the gold in its vaults and can use it for future intervention operations. If demand exceeds supply, the government also has to intervene. It has to meet the shortage in supply by selling gold out of its reserves.

A system of fixed exchange rates provides for an automatic balance-of-payments adjustment mechanism. Assume that the foreign exchange market in the United States is initially in equilibrium. Subsequently, an increase in import spending creates a balance-of-payments deficit. This deficit leads to an automatic adjustment over time, since US importers buy gold from the Federal Reserve (see FEDERAL RESERVE SYSTEM), thus decreasing the US money supply. The gold will be shipped to the euro zone and sold to the central bank for euros, which increases the euro zone's money stock. The monetary contraction in the United States raises interest rates and lowers spending, whereas the monetary expansion in

the euro zone leads to lower interest rates and higher spending. These changes in spending feed back into the foreign exchange market, though not instantaneously since the adjustment process takes time.

A problem with the adjustment process under the gold standard is that countries with trade deficits and gold outflows experience deflation, which may cause recessions. In addition, countries that are on the gold standard have little control over their money supply, since it is dominated by gold flows. International trade can thus cause unexpected deflation or INFLATION. Furthermore, gold production can strongly affect the world money supply under the gold standard, which may also disturb countries' MONETARY POLICIES. During World War I, many countries responded to the collapse of the international trading system by abandoning their currency's convertibility into gold, which heralded the demise of the gold standard.

After World War II, a new international monetary and financial system was designed. It is known as the BRETON WOODS SYSTEM and was effective in the period 1945–71. It was an adjustable peg system with a lender of last resort to smooth out short-term economic adjustment in response to balance-of-payments deficits. Countries fixed the value of their currencies in terms of dollars, while central banks could convert US dollars into gold at a fixed price of \$35 per ounce. This system can thus be called a gold/dollar standard, since the dollar served as the key currency.

In principle, a central bank could maintain the exchange rate by buying and selling sufficient amounts of its currency. The ability to buy its own currency, however, is limited by the country's stock of international reserves. An alternative to buying and selling reserves is changing the exchange rate. A devaluation lowers the currency's value relative to the dollar, making foreign goods relatively more expensive and domestic goods relatively cheaper. This would reduce import spending and boost exports, which would reduce a balance-of-payments deficit. A revaluation raises the currency's value relative to the dollar,

flags of convenience (FOCs)

which makes foreign goods relatively cheaper and domestic goods relatively more expensive. This would have the opposite effect of raising import spending and reducing exports, thereby lowering a balance-of-payments surplus.

By 1971, the dollar assets owned by central banks outside the United States totalled more than three times the US gold holdings at the agreed rate of \$35 per ounce of gold. This was an important reason for the US government to suspend the convertibility of dollars into gold and to impose tariffs on imports that would be reduced only if a country revalued its exchange rate. The Bretton Woods system was thus formally and effectively abandoned. As a result, many exchange rates floated in the 1970s, being determined by demand and supply on the foreign exchange market.

See also:

exchange rate; flexible exchange rates; floating exchange rates; foreign exchange; foreign exchange reserves

M. PETER VAN DER HOEK

flags of convenience (FOCs)

Flags of convenience (FOCs) refer to the registration of ships on the 'open registries' of countries which serve as tax havens, offer freedom from labour regulation, and demand minimal safety standards and enforcement. The role of the host state is, by definition, minimal; actions deemed 'inconvenient' by shipowners would defeat the purpose of the institution. Thus flags of convenience are analogous to offshore banking which became prevalent in the 1960s with the advent of the eurodollar market (see OFFSHORE FINANCE). FOCs offer an early example of the globalization of capital and trade. At the same time, however, their use has stemmed from international political and economic rivalries, and has tended to enhance the power of the US state and multinational corporations.

The use of FOCs arose out of post-World War I economic and political conditions in shipping, but did not become widespread until after World War II, when a group of American businessmen led by former US Secretary of State Edward Stettinius established a registry in Liberia. The statute of the Liberian registry, written at the behest of US oil multinationals, was even more congenial to US corporations than the existing Panamanian registry. While guaranteeing minimal regulation, it also stipulated that American-owned vessels could be requisitioned by the US government for military use. The establishment of FOCs thus solved a number of problems for American multinational corporations. Bulk and tanker shipping, in which key raw materials and oil are carried, was traditionally the preserve of western European shipowners, who enjoyed a substantial comparative advantage over their US counterparts, particularly in labour costs. Hence, after World War II, the rapidly expanding US raw materials multinationals had the choice of relying on European shipping or establishing an alternative system capable of competing with the traditional maritime powers. By allowing US multinationals either directly to operate or to purchase shipping services from independent bulk and tanker owners, FOCs buttressed American hegemony, shifting – albeit indirectly – the centre of gravity of global shipping from Europe to the United States. By the late 1940s, Liberia and Panama had become the key flags of convenience. By 1991, the combined fleets of Liberia, Panama, Cyprus and the Bahamas represented more than 25 per cent of world shipping tonnage.

During the 1950s, FOCs withstood the combined challenge of European shipowners and their governments, and also of international maritime labour. As the Europeans recognized, FOCs had become a key manifestation of US maritime policy, the defence of which constituted a competitive US policy aimed primarily at western Europe and defended with reference to the principle of privatization. In a largely unregulated environment in which labour markets were subject to

market forces and taxation was minimal, FOCs allowed US extractive and agribusiness industries to integrate transportation into their burgeoning global operations. The traditional maritime powers of western Europe, joined by maritime unions, favoured regulation, which required a substantial link between ownership and flag. In the COLD WAR climate, however, the American preference for deregulation prevailed.

In 1958, the International Transport Workers' Federation staged a worldwide boycott against FOCs, but received little support from European shipowners. Neither the actions of maritime unions nor a series of investigations by the International Labour Organization were able to prohibit or significantly influence their practice.

During the 1970s, LESS-DEVELOPED COUNTRIES (LDCs) also sought to curb the practice of open registries. Recognizing that they possessed a potential comparative advantage in bulk and tanker shipping, they believed that the abolition of FOCs would enable them to establish a presence in international shipping. Working largely through the UNITED NATIONS CONFERENCE ON TRADE AND DEVELOPMENT (UNCTAD), they sought to phase out the practice of FOCs. Less-developed countries pointed out that flags of convenience contributed to relatively low wages and poor working conditions throughout the industry. At the same time, problems of pollution (especially oil spills) and poor safety standards were directly attributed to the weak regulatory regime resulting from FOCs. Once again, however, America's strong support for FOCs precluded change and the UNCTAD challenge gradually died out in the 1980s.

Thus FOCs remain a key factor in international shipping. By the late 1980s, under circumstances of intensified competition in shipping and the weakening power of maritime unions, many shipowners from the traditional maritime powers of western Europe began to take advantage of FOCs. As a result, the regulatory systems of the major maritime powers have begun more closely to resemble those of FOC states.

See also:

International Maritime Organization (IMO); shipping

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ALAN CAFRUNY

flexible accumulation

During the 1950s and 1960s, Fordism was the dominant system of production and distribution in advanced capitalist economies. It was characterized by assembly line production, economies of scale and mass consumption (the 'intensive regime of accumulation'). But since the 1970s, the Fordist system has been in relative decline. A new flexible accumulation system (FAS) is developing rapidly at the start of the twenty-first century. It commenced in Japan as 'Toyotism' or the 'Japanese system of production', and is progressing through the global systems of production at differential levels.

Main characteristics

The FAS has three main characteristics. The first is 'just-in-time production' (JIT), which is concerned with the elimination of wasted output, time and space in production and circulation. JIT requires decentralized adjustment

of inputs, a minimum use of inventories and close relationships between producer, supplier and buyer. Synchronization is necessary in all the main stages of production, with efforts being made to resolve anomalies such as absenteeism, machinery malfunction and resource bottlenecks. Job rotation and multi-skilling help to sustain the flow of capital through the many stages of production and distribution.

The second characteristic is total quality management (TQM). TQM is critical because stocks are reduced to near zero, which means that the number of inferior products needs to be very low. A number of strategies are employed to promote quality, such as workers and foremen checking samples in their segments of production; quality control departments employing on-line inspections and statistical process control, and the 'fault inspection' phase which isolates many defects. Fundamentally, though, TQM is a philosophy which permeates every phase of production, with workers not only checking products continually, but also identifying anomalies in the system which if rectified can enhance quality (see Harriss, 1995). Also important to TQM is the '5s' system. This is oriented around making the workplace clean, tidy, orderly, neat and disciplined, and around reducing costs. In John Harriss' study of the Indonesian car companies, for instance, the three companies each organized 'quality circles' or 'production teams', which are typical of TQM practices. These teams tend to meet outside normal working hours discussing how to incorporate new methods of quality improvement. Participation in the quality circles is considered important for promotion.

Third, flexible accumulation includes some degree of worker participation and skill development. The Japanese 'flexible system' seems to have solved some of the conflicting problems between capital and labour through promoting the idea of unity, family, participation, worker suggestions, bonuses and 'harmony'. Workers need to be multiskilled, since their tasks are often rotated in an attempt to promote flexibility and reduce bottlenecks caused by

absenteeism, strikes and so on. Many of the companies have shared lunch areas for workers and managers; a similar type of clothing for all employees; cooperatives for purchase of groceries; weekend picnics, and financial assistance with housing. The common system of work teams serves to bond workers and supervisors together, making it a collective work environment.

Effectiveness in the West

Edwin Mansfield (1992) made a detailed analysis of the effectiveness of flexible accumulation in the United States. First, he found that it significantly cut labour costs, material costs and levels of inventories. It generally reduces the costs of lower production runs and minimum efficient size. This is because of the lower costs of storage, reduction in bottlenecks and greater motivation of workers. Second, the success rate for firms in Japan was higher than in the United States and most other nations. Third, the rate of return for flexible systems is less in automotive than aerospace, electrical equipment or machinery sectors. This seems to be because auto companies tend to produce items in large volumes, which is not the production profile of comparative advantage for flexible accumulation.

Success in less-developed nations

Raphael Kaplinsky (1995) examined the workings of the flexible system in less-developed countries (LDCs). He found that with the flexible mode, labour is seen less as a cost and more as a form of human capital which needs to be nurtured and developed. Also, a participatory culture is necessary, rather than the old 'me and them' philosophy between capitalists and workers. It is critical for management to increase the level of skill, adaptability and participation of the workforce. Many of the problems necessitate more training on the job or in special workplaces. But as the range of techniques are increased, the requirements for formal education tend to grow.

Kaplinsky studied inter-firm cooperation,

management and culture and found that the flexible system made greater demands on suppliers and the whole chain of producers to increase quality. Hence, the further flexibility is adopted, the more it cumulatively affects costs and quality. In LDCs, the training techniques and curricula are often still oriented towards outdated Fordist methods. But in many parts of Asia the culture is closer to Japan than in the advanced Western economies, which is a benefit to the Asian nations. Governments can aid the process of adapting to the newer flexible systems.

Conclusion

Flexible accumulation is becoming more pronounced throughout the world economy. An important question is whether it will help to create a new regime of accumulation to resolve the current problems of capitalist reproduction. Many suggest that it may, but that it is not a qualitative advance on the old style system of workplace relations. Tony Smith (1994: 58), for instance, argues that: 'Structural coercion, exploitation, and the real subsumption of labour under capital remain in flexible production systems.' Nevertheless, it is in many respects an advance on the old Fordist system and provides a real (but possibly limited) potential for the creation of better material conditions for human life.

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PHILLIP ANTHONY O'HARA

flexible exchange rates

The exchange rate is the value of the domestic currency in terms of foreign currency. When governments or central banks do not intervene in the foreign exchange market, demand and supply for a currency determine the exchange rate. This is called a 'system of flexible exchange rates'. It should be distinguished from a system of managed (or dirty) floating, in which the exchange rate is basically floating but governments intervene to try to move the exchange rate in a desired direction.

A flexible exchange rate is determined by three factors:

- 1 Price levels abroad and at home. A fall in the price of goods made in the euro zone relative to goods made in other countries will lead to an appreciation of the euro.
- 2 Real factors related to trade flows. A gain in export markets for exporters from the euro zone will lead to an appreciation of the euro.
- 3 International capital flows. An increase in interest rates in the euro zone will attract capital from other countries, which leads to an appreciation of the euro.

Fully flexible exchange rates are set by expectations in foreign exchange markets without any official intervention. Under this system, the exchange rate is the price that clears the foreign exchange market. Leaving international borrowing and lending aside, the quantities of currencies demanded and supplied are determined by exports and imports.

floating exchange rates

Exports yield receipts of foreign exchange. Hence they are the source of supply of foreign exchange. Importers have to obtain foreign currency to pay for the goods they import. Therefore, imports are the source of demand for FOREIGN EXCHANGE.

Assume that the price of the euro is so low that the quantity of euros demanded exceeds the quantity supplied. This implies that some people who wish to convert foreign currencies into euros are unable to do so. As a result, the price of euros will be bid up and the value of the euro will appreciate. If the demand for goods is elastic this works as a double-edged sword. First, exports from the euro zone to other countries will decrease, since goods made in the euro zone will become more expensive relative to foreign goods. Therefore, export revenue will fall. As exporters receive less foreign currencies, their demand for euros will decrease. Second, the appreciation of the euro will boost import spending by making foreign goods cheaper relative to goods made in the euro zone. This will increase the supply of euros to be exchanged for foreign currencies, which are needed to pay for the higher imports. Thus a rise in the price of the euro reduces the quantity demanded and increases the quantity supplied.

Alternatively, the price of the euro can be above its equilibrium value. The quantity of euros demanded is less than the quantity supplied and some people who offer euros to acquire foreign currencies are unable to obtain them. The price of foreign currencies will now be bid up and the value of the euro will depreciate. If the demand for goods is elastic, equilibrium will again be restored through two channels. First, exports from the euro zone become more competitive in terms of price which increases export revenue. Second, the fall of the price of the euro reduces import spending by making foreign goods more expensive relative to goods made in the euro zone.

Fully flexible exchange rates are thus an automatic mechanism of balance-of-payments adjustment. Under a flexible exchange-rate system, the foreign exchange market is a

competitive market in which forces of demand and supply lead to an equilibrium price at which quantity demanded equals quantity supplied. There is no need for government intervention to establish external equilibrium. The exchange rate will move to restore balance between import spending and export revenue. International capital flows (borrowing and lending) give rise to some complications, but do not affect the basic principle that fully flexible exchange rates automatically adjust the balance of payments.

See also:

fixed exchange rates; floating exchange rates; foreign exchange reserves

M. PETER VAN DER HOEK

floating exchange rates

The terms 'floating exchange rates' and 'flexible exchange rates' are often used interchangeably, but two different systems of floating rates can be discerned: clean floating and dirty (or managed) floating.

Clean floating means that central banks do not intervene in the foreign exchange market, which implies that official reserve transactions are zero. Central banks thus permit the market to freely determine exchange rates. In the absence of government intervention, supply and demand for the currency are equal. A floating exchange rate clears the market. As a result, the current and capital accounts of the balance of payments total zero.

In a system of dirty or managed floating, central banks do intervene in the foreign exchange market. In attempts to influence exchange rates, they buy and sell foreign currencies. Under a system of dirty floating, official reserve transactions are not zero and the exchange rate does not necessarily clear the market.

See also:

exchange rate; fixed exchange rates; flexible exchange rates; foreign exchange; foreign exchange reserves

M. PETER VAN DER HOEK

flyng geese model

When wild geese migrate, they fly in a V-formation. This model of a flying geese formation has been used to describe a regional pattern of economic development in East and South-East Asia, with Japan as Asia's leading goose, the newly industrialized economies (NIEs) (Hong Kong, Singapore, South Korea) following in the second rank, the ASEAN countries in the third rank, and China and Vietnam in the fourth.

However, in the same way as Japanese economic relations with the rest of East Asia have changed, so too has the flying geese model. This was originally formulated by Kaname Akamatsu in 1932 when Japan was still seeking to catch up with the more advanced countries of Europe and America (Akamatsu, 1962). In Akamatsu's version, trade was seen as the major medium for technology stimulus. The leading country's exports would compete with and initially wipe out competitors' products in the following or backward countries. However, with the local market growing, producers in the backward countries would counter-attack and, with the help of government support and protection, they could begin to compete with the imports from the leading country. As producers in the backward country mastered the new technology associated with the formerly imported products, the producers in the leading country would, in turn, be impoverished. Thus Akamatsu's flying geese model was a 'life-and-death' struggle conducted through trade, with Japan being a backward country.

This is quite different from later interpretations, such as that of Ozawa in 1995. According to this interpretation, the leading country

becomes Japan, the mechanism for change is not trade but transnational corporations (TNCs) (see MULTINATIONAL CORPORATIONS (MNCs)) and, most importantly, the vision presented is a relatively harmonious one. Ozawa presents the process as one in which an outward-oriented, export-focused strategy is passed on through the flock with the followers feeding on the growth stimuli transmitted from the advanced economies. The backward economies mutually benefit from the competitiveness-enhancing effects of TNCs' activities. The image presented is one in which comparative advantage is 'recycled' at little or no cost.

This harmonious image is one point of criticism that Robert Rowthorn (1996) (a Cambridge University economist) has made of the flying geese model as presented by Ozawa. In addition, Rowthorn argues that Ozawa has exaggerated *both* the role of Japan as the leader of East Asian development *and* the role of TNCs as the agents of change. However, in spite of these criticisms, Rowthorn broadly accepts that the model is useful for understanding the ways in which industrialization is transmitted from one wave to another of developing countries.

See also:

comparative advantage; product-cycle model

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CHRIS EDWARDS

Food and Agriculture Organization (FAO)

The Food and Agriculture Organization (FAO) is the largest autonomous agency within the UNITED NATIONS (UN) system, with 175 member-nations plus the EUROPEAN UNION (EU) as a member-organization. It was founded in October 1945 in Quebec City, with a mandate to raise levels of nutrition and standards of living, to improve agricultural productivity and to better the condition of rural populations. Its headquarters moved in 1951 from Washington, D.C., to Rome.

Since its inception, the FAO has worked to alleviate POVERTY and hunger by promoting agricultural development, improved nutrition and the pursuit of food security – the access of all people at all times to the food they need for an active and healthy life. The FAO offers direct-development assistance; collects, analyses and disseminates information; provides policy and planning advice to governments, and acts as an international forum for debate on food and agriculture issues. It also plays a major role in dealing with food and agricultural emergencies.

Nowadays a specific priority of the FAO is encouraging sustainable agriculture and rural development, aiming to meet the needs of both current and future generations.

J.E.C. ENGELBERTS

Fordism, crisis of

Interpretations of institutional shifts in capitalist industrial countries have used 'Fordism' and 'crisis' as important organizing concepts, but 'Fordism' can have different meanings and supports different kinds of historical interpretations and political positions.

A term which ANTONIO GRAMSCI originally associated with a constellation of cultural and political relations that he referred to collectively as 'Americanism', Fordism has more recently been appropriated by scholars associated with

more economically centred REGULATION THEORIES. Michel Aglietta (1979) identified Fordism as the regulative principle of a macro-social REGIME OF ACCUMULATION (ROA) involving specific forms of capitalist production, as well as social consumption norms. Aglietta attributed the GREAT DEPRESSION to the uneven early development of a regime of intensive accumulation, revolutionizing social productive powers in the United States without simultaneously transforming social consumption norms and the real living conditions of the industrial working class. The result, he claimed, was catastrophic economic imbalance, as the rapidly growing sector of production goods outpaced the consumption goods sector.

After World War II, Fordism realized capitalism's potential for mass production at the same time as fostering a rising standard of living for many production workers. Based on the intensification of labour, Fordism's increasing rate of EXPLOITATION countered (for a time) the tendency towards a FALLING RATE OF PROFIT (FRP) as capital revolutionized the social forces of production and progressively reduced the proportion of exploitable living labour involved in the production process. At the same time, growing productivity and the cheapening of wage-goods meant that the real standard of living of the industrial working class could improve significantly even as exploitation intensified. Increasing levels of social consumption – secured through such institutional mechanisms as UNIONIZATION and legalized collective bargaining – in turn promoted a rough balance between the producer-goods and consumer-goods sectors during Fordism's golden age.

By the late 1960s, Aglietta argued, the engine of intensive accumulation was stalling. The growth of social productivity decelerated markedly after 1966: the Fordist labour process, based on the extraction of ever greater amounts of SURPLUS VALUE through the intensification of labour, was reaching its limits. Once this dynamic lost its momentum, real wages could not continue to grow and capital began a massive frontal assault on workers, their unions and their wages. As

Fordist production approached its limits, the danger of capitalist crisis began to reassert itself: the degenerating regime of intensive accumulation became less able to offset the basic crisis tendencies of capitalism through steadily intensified exploitation, increasing productivity and mass consumption of mass-produced commodities.

Aglietta's concepts enjoyed, for a time, a widespread popularity, spawning regulation theory, influencing a number of important works of scholarship and setting the tone of much academic discussion of political economy through the 1980s. In recent years, however, Aglietta's claims about Fordism have been subjected to serious criticism. R. Brenner and M. Glick (1991) argued persuasively that Fordism should not be understood in terms of the institutionalized correspondence of mass production and mass consumption since the pre-Depression years were not a period of extraordinary UNDERCONSUMPTION, nor was consumption historically high relative to total output in the post-war 'golden age' (Brenner and Glick, 1991: 84, 93–5).

But Fordism can also be understood in terms of a socio-political regime, a set of institutionalized relationships between the social organization of production on the one hand, and social self-understandings and political organizations on the other. Gramsci was among the first to recognize the potential political and cultural significance of 'an ultra-modern form of production and of working methods – such as is offered by the most advanced American variety, the industry of Henry Ford' (1971: 280–1). The institutionalization of such a system of production required a combination of force and persuasion: a political regime in which trade unions would be subdued, workers might be offered a higher real standard of living and the ideological legitimation of this new kind of capitalism would be embodied in cultural practices and social relations extending far beyond the workplace.

In the first half of the twentieth century, craft-based production was being supplanted by mass production in the United States and new relations of power were being constructed

and contested in the workplace. Fordism entailed increased mechanization of the labour process and the potential for heightened capitalist control over the pace and intensity of work. Realization of that potential involved bouts of explicit CLASS STRUGGLE. Contesting liberal capitalism's emphasis on private property rights, industrial workers counterposed conceptions of INDUSTRIAL DEMOCRACY and collective participation in work life in order to legitimate their new and embattled industrial unions. In the post-war context of Cold War fears and access to an unprecedented affluence, such challenges were contained within the bounds of a vision of liberal capitalism as the social system best able to secure – on a global scale – individual rights and liberties and a more generalized prosperity. On the basis of union participation in this hegemonic world-vision, the state and capital accepted industrial unions as junior partners in the post-war project of reconstructing a liberal capitalist world order (Rupert, 1995).

In the last decade of the twentieth century, this Fordist hegemony was transforming itself. The Cold War was over: anti-communism no longer served as the crucial ingredient in the ideological cement binding together the post-war historic bloc. The prosperity which US industrial labour had enjoyed as a result of its participation in the hegemonic bloc was evaporating. With the mutation of the post-war historic bloc, such that transnational financial and industrial capital are increasingly predominant and industrial labour within the United States is no longer a relatively privileged junior partner, socio-political relations and popular ideologies which once seemed firmly grounded are now increasingly up for grabs.

In sharp contrast to the hegemonic ideology of Fordism, working Americans increasingly realize that they live in an environment where corporate profits need not correspond to rising standards of living or improved quality of life and that their ability to exercise any control at all over their economic futures is, under current institutional arrangements, quite limited. Mounting evidence of long-term tendencies towards transnational production, corporate

Fordism, developmental model of

restructuring, subcontracting and outsourcing, plant closings and layoffs, concessionary bargaining and union-busting, declining real wages, widening and deepening poverty, has in recent years been juxtaposed to news of resurgent corporate profits, happy days on Wall Street and breathtaking inequalities of income and wealth. The liberal vision of a transnational order institutionalizing the values of freedom and prosperity – most firmly embedded in popular common sense during the post-war decades – may begin to seem bitterly ironic to growing numbers of Americans. Once solidly hegemonic, the liberal narrative of globalization is now increasingly vulnerable to challenge.

See also:

Fordism, developmental model; Fordism: mode of regulation; Fordism: regime of accumulation; regulation theory

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MARK RUPERT

Fordism, developmental model of

As a developmental model, Fordism can be regarded as a consistent set of rules that define a particular way of organizing production, and as a cultural pattern that affects the nature of labour management relations and managerial

decision-making. As its name suggests, Fordism originated with the innovations at the Ford Motor Company in the 1920s. As a set of rules for organization, it was developed to achieve the highest efficiency and the greatest ECONOMY OF SCALE in the mass production of standardized goods. At the same time, its success demands the growth of a large consumer market for mass-produced goods.

The basis of the Fordism developmental model was one of price; hence the primary focus in production was on cost reduction. Product homogeneity best enabled this competitive objective to be achieved and the optimum location of production was on the side of least cost. Since labour costs were an important component of cost in many sectors, this was an important source of COMPARATIVE ADVANTAGE to LESS-DEVELOPED COUNTRIES (LDCs) and helps to explain the rise in export-oriented industries in the 1970s.

By contrast, post-Fordist (see POST-FORDISM) product characteristics and product innovation are the primary determinants of competitiveness and, instead of optimal location being affected by low costs, it is much more likely to be near final markets so that consumers can be served more effectively.

A second major difference between Fordist and post-Fordist developmental models concerns the role of labour in achieving competitiveness. Since price was the dominant form of competition in Fordism, labour was seen as a cost of production that had to be minimized. By contrast, in post-Fordism, innovation is the most important competitive attribute and labour is seen as a primary resource. Thus, while for Fordism to be most effective it required the subordination of workers by management, post-Fordism requires a cooperative relationship on the shopfloor. From the point of view of LDCs, this diminishes the competitive advantage of cheap labour and throws the emphasis on skill creation.

See also:

Fordism, crisis of; Fordism: mode of regula-

tion; Fordism: regime of accumulation; regulation theory

ROBERT LOONEY

Fordism: mode of regulation

Fordism was first described as a **MODE OF REGULATION (MoR)** by M. Aglietta, a pioneer of **Parisian REGULATION THEORY**, in his history of American capitalism. The emergence in the 1940s of the Fordist mode, also described as a monopolistic mode, solved the structural crisis of the **Fordist REGIME OF ACCUMULATION (ROA)**. Thanks to the Fordist mode, the mass-production characteristic of the Fordist regime was matched by mass consumption. The Fordist mode consists of four structural forms: (1) collective bargaining secures stable wages for workers in return for their recognition of management control over the labour process; (2) monopolistic competition among large firms enables them to adjust workers' consumption to productivity gains; (3) a new monetary system provides credit in support of workers' consumption, and (4) state intervention in the economy smoothens the fluctuations in the business cycle. By the 1960s, the operation of Fordism had stimulated inflation and waste, while intensifying worker **EXPLOITATION**. Increased worker resistance to Fordist production methods precipitated the crisis of the Fordist mode in the 1970s. A solution to the structural crisis of capitalism presupposes the emergence of a new regime of accumulation and a corresponding mode of regulation, but since no new regime has proved successful, the nature of a 'post-Fordist' mode of regulation remains a matter of controversy.

See also:

capitalist crisis; Fordism, crisis of; Fordism: regime of accumulation; post-Fordism; regulation theory

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ALFREDO C. ROBLES, JR

Fordism: regime of accumulation

Fordism was first described as a **REGIME OF ACCUMULATION (ROA)** by M. Aglietta, a pioneer of Parisian regulation theory, in his history of American capitalism. In a Fordist regime (also described as intensive accumulation), a reorganized (Taylorist) labour process increases productivity and extracts relative surplus value. Fordism was born when **TAYLORISM** was integrated into a system of machines. Fordism's characteristic feature is semi-automatic assembly-line production and supposes a new three-level division of labour (conception, organization of methods and engineering; skilled manufacturing; unskilled assembly and execution). Fordism generated a boom in intensive accumulation that was not matched by increased consumption, since mechanisms of wage formation were inadequate. This resulted in a crisis of intensive accumulation in the 1930s. From the workers' struggles during that period there emerged a monopolistic or Fordist **MODE OF REGULATION (MoR)**; the correspondence between the Fordist regime and the monopolistic mode allowed intensive accumulation to flourish until the mid-1960s. The increased exploitation inherent in the Fordist regime generated worker-resistance to Fordism and precipitated the crisis of the regime itself in the 1970s. The solution to this structural crisis supposes the emergence of a new regime, but no clear model of a 'post-Fordist' regime has yet emerged.

Foreign Assistance Act

See also:

capitalist crisis; deskilling; Fordism. crisis of; Fordism: mode of regulation; post-Fordism; regulation theory

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ALFREDO C. ROBLES, JR

Foreign Assistance Act

The United States Foreign Assistance Act of 1961 replaced the Mutual Security Act and established the Agency for International Development as the agency for administering economic assistance to the developing world. It reflected a partial shift in US policy away from military assistance as an instrument in fighting the COLD WAR to the use of aid for economic development in poor countries. The new paradigm was that economic development, as opposed to traditional military assistance, would foster stable economies and thus countries less prone to domestic conflict - and more likely to cooperate with their neighbours. The amended act still guides US economic and military assistance.

See also:

poverty

PAUL G. HARRIS

foreign direct investment (FDI)

Foreign direct investment (FDI) is a major feature of contemporary international economic relations. It contrasts with PORTFOLIO

INVESTMENT which was the dominant form of international investment in the nineteenth century. Since World War II, FDI has outstripped the growth both of world production and international trade. There have also been significant changes in the origins and destination of foreign investment during this period. Its growth has implications both for home and for host countries.

Definitions

Foreign direct investment refers to investment overseas through which the investing firm acquires *control* over the firm in which it invests. The IMF defines FDI as

investment that involves a long-term relationship reflecting a lasting interest of a resident entity in one economy (direct investor) in an entity resident in an economy other than that of the investor. The direct investor's purpose is to exert a significant degree of influence on the management of the resident in the other country.

(from Dunning, 1993: 5)

For empirical purposes, control is defined in terms of the acquisition of a minimum percentage share holding in the foreign subsidiary. The ORGANISATION FOR ECONOMIC CO-OPERATION AND DEVELOPMENT (OECD), for example, recommends a share holding of 10 per cent as sufficient to define a transaction as involving FDI, but different countries have adopted different cut-off points.

Growth and significance

Until recently direct foreign investment was regarded as very much a post-World War I phenomenon, which had been of marginal importance during the nineteenth century. However, recent re-evaluations have claimed that as much as a third of the accumulated stock of worldwide foreign investment was direct investment in 1914, a total of over \$14 billion. By 1938, this had almost doubled to \$26 billion, before really taking off in the 1950s

to reach \$66 billion by 1960. Since 1960, FDI has grown at twice the rate of growth of international trade and almost three times the growth of world output. In 1999, the total stock of FDI worldwide was estimated at US\$4.772 billion (United Nations Conference on Trade and Development, 2000: Table I.1).

Geographical distribution

The bulk of FDI comes from a small group of advanced industrial countries. Between World War I and World War II, Great Britain was the major source of FDI, accounting for 45 per cent of the total stock in 1914 and 40 per cent in 1938 (Jones, 1996). The dominant position shifted decisively to the United States as a result of World War II, a position which it has maintained ever since, despite its declining share of the total stock. Britain followed in second place until it was overtaken by Japan, where foreign investment grew extremely rapidly in the 1980s and early 1990s. Together with Germany, France and the Netherlands, these countries have dominated FDI throughout the twentieth century.

Inward FDI is also concentrated in the advanced industrial countries, which have accounted for between 70 and 80 per cent of the total stock since the 1960s (Dunning, 1993: Table 2.5). There have, however, been significant changes in the distribution of inward investment among the developed economies, with a very sharp increase in the significance of the United States as a host country since the mid-1970s.

Developing countries have accounted for about a quarter of all FDI since the 1960s. There was an apparent trend for this share to decrease until the late 1980s, but there is some evidence that this has been reversed since then, mainly as a result of the dramatic increase in foreign investment in China in recent years. Among the developing countries, there has been a very marked concentration of FDI in a small number of countries, with about ten economies accounting for two-thirds of the stock of investment. These have tended to be primarily the NEWLY INDUSTRIALIZED COUN-

TRIES (NICs) of Asia and Latin America. As a result, most of the Third World (accounting for the bulk of the world's population) has received only a very limited share of total FDI.

Sectoral distribution

The sectoral composition of FDI has tended to change substantially over time. Until World War II, such investments were concentrated mainly in the extractive industries. As tends to happen with the share of primary industries in national output as income rises, the share of foreign investment allocated to these activities fell in the post-World War II period and that of manufacturing increased. By the mid-1970s manufacturing accounted for about half the total stock of FDI for the major outward-investing countries (United Nations Centre on Transnational Corporations, 1988: Table V.4). Since then, the share of manufacturing has declined for all the major capital-exporting countries and that of the service sector has increased.

Theories of foreign direct investment

Foreign direct investment was originally thought of simply as an international capital flow and analysed as an extension of international trade theory. However, by the 1960s it was realized that FDI consisted of much more than just capital and generally involved a 'package' of assets and intermediate products, such as capital, technology, management skills, access to markets and entrepreneurship.

As a result, FDI came to be seen as an aspect of the theory of the firm and industrial organization. The attempts to analyse foreign investment from this perspective included product-cycle theory (see PRODUCT-CYCLE MODEL) and various theories concerning MULTINATIONAL CORPORATIONS (MNCs). These broke new ground in recognizing the specific institutional form within which most FDI took place.

Determinants of FDI

Firms are influenced by a number of economic and political factors in deciding where to invest overseas. Empirical studies have identified a number of major determinants. Firms tend to invest in countries with large or rapidly growing markets and high income levels. They also tend to prefer to invest in countries with well-developed infrastructure. Interestingly, a less significant factor determining investment is the level of labour cost in a country. Political factors which are regarded as important are the level of political instability or political risk and, particularly during the Cold War, the relationship of a country with the West.

Although governments frequently provide tax and other fiscal incentives to foreign investors, there is little evidence that these are an important determinant of FDI. It may be the case that those countries which are least attractive to foreign investors tend to resort most extensively to such incentives, but that these are insufficient to offset the other disincentives in the eyes of many investors. Another factor which does not seem to have a major impact on FDI is the liberalization of the foreign economy. Protection acts as an incentive for certain kinds of investment which seek to serve the domestic market, whereas it may be a disincentive to investment for export.

Impact on home economies

There has always been an element of concern over the impact of FDI on the countries from which it comes. The underlying thought is that reinvestment in the domestic economy is preferable to investment elsewhere. Whereas investment overseas may be privately profitable, there may be a divergence between private and social costs and benefits, particularly since in the case of investment overseas any externalities and tax revenue occur to the host country.

The evaluation of the impact of FDI on the home country depends crucially on the assumptions which are made concerning what might otherwise have occurred. Three alter-

natives have been identified in the literature. First, the 'classical assumption' regards foreign investment as an addition to capital accumulation in the host country and an equivalent reduction in the home country (in other words domestic and foreign investment are direct substitutes). Second, the 'reverse classical assumption' regards FDI as being primarily 'defensive' and that it therefore substitutes for investment in the host country without reducing capital accumulation at home. Finally, the 'anti-classical assumption' regards FDI as a net increase in world capital formation, since it does not reduce investment in the home country and adds to investment overseas. If the 'classical assumption' holds then there are grounds for concern for the home country, but in either of the other two cases, the capital-exporting country benefits.

Impact on host economies

There is a substantial literature on the impact of FDI on recipient countries. As in the case of home countries, a crucial question here is whether inflows of FDI are additional to or substitutes for domestic investment. On the assumption that FDI adds to domestic resources. FDI can be seen as filling a number of gaps in host economies. First, it can help bridge a resource gap between a desired level of investment and locally available savings. Second, it can help close a foreign-exchange gap where a country suffers from balance-of-payments pressures. Third, it may provide additional tax revenues to hard-pressed governments facing fiscal deficits. Finally, it can provide additional managerial and technical skills where these are in short supply. Although these effects may seem particularly important for developing countries, advanced industrial countries have also often been keen to attract FDI for similar reasons, particularly to obtain technology and managerial skills (as in the case of Japanese management techniques).

Many of the concerns which have been raised about FDI reflect a fear that it is often a substitute for domestic investment and that it

may displace local firms and crowd out domestic entrepreneurship. These fears are particularly acute because the bulk of FDI is undertaken by multinational corporations which often have substantial market power. Other concerns are for the long-term balance-of-payments effects of FDI when profit remittances begin to outweigh new capital inflows. Finally, there is also a fear that a high level of dependence on FDI will lead to a loss of national sovereignty.

See also:

New International Division of Labour (NIDL)

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RHYS JENKINS

foreign exchange

Foreign exchange consists of foreign currencies and of claims to them, in such forms as bank deposits, cheques and promissory notes. The market in which such currencies are traded is the FOREIGN EXCHANGE market and governments intervene in this market to attempt to control the international monetary flows generated by different national MACRO-ECONOMIC POLICIES. However, such intervention is easily overwhelmed by private speculative flows – the daily volume of foreign exchange trading has grown at a phenomenal rate over the last few decades and typically exceeds the combined foreign reserve holdings of leading central banks.

ALISON M.S. WATSON

FOREIGN EXCHANGE GAP *see* development; two-gap model; underdevelopment

foreign exchange reserves

Foreign exchange reserves are the stock of foreign currency held by the domestic central bank of a country in order to finance any demands that may be made by its creditors for the settlement of debt. The degree to which such demands are made depends both on the extent of the debt (which, in turn, is related to the balance-of-payments position of the country) and on the willingness of the creditors to hold the debt (currency). Pressure on a country's FOREIGN EXCHANGE may thus be either a reflection of underlying balance-of-payments problems, or a result of the expectation of a future fall in the EXCHANGE RATE value of the country's currency.

foreign sales corporations (FSCs)

The officially published figures of the extent of a country's foreign exchange reserves do not necessarily reflect the total amount of foreign currency that could actually be used to meet obligations. The figures often exclude, for example, the credit facilities that are available through the SPECIAL DRAWING RIGHTS (SDRs) facility of the INTERNATIONAL MONETARY FUND (IMF), and the extent of foreign INVESTMENT that a country holds.

See also:

foreign exchange

ALISON M.S. WATSON

foreign sales corporations (FSCs)

Foreign sales corporations (FSCs) are wholly owned affiliates of US corporations that are registered in foreign countries for the purpose of saving taxes. FSCs operate as conduits for a range of exports of US companies but, by being technically foreign-registered, have received favourable tax treatment under the US Inland Revenue Code Sections 245(c), 921–27 and 951(e).

The EUROPEAN COMMUNITY (EC) challenged the legality of the FSCs at the WORLD TRADE ORGANIZATION (WTO) in 1997, claiming that their favourable tax treatment constituted an improper form of export subsidy (see SUBSIDIES). The initial WTO panel judgement supported most of the European Community's case in October 1999 and the bulk of this judgement was then upheld by the WTO's Appellate Body in February 2000.

Three forms of favourable tax treatment for FSCs were highlighted by the WTO panel and appellate board:

- 1 an exemption from any factual enquiry as to whether a FSC was actually wholly controlled by the parent company (as would be the case for a non-FSC affiliate) and was hence justified in being treated effectively as an unconnected business;

- 2 an exemption from the normal requirement for a parent company to declare attributable, but as yet undistributed or not remitted, income (Subpart F income) from foreign affiliates as part of current income tax purposes;
- 3 the exemption of dividends received from FSCs from normal taxation within the United States.

The decision of the WTO's Appellate Body to uphold the bulk of the complaints against FSCs came at a time of some delicacy within the United States, as a looming presidential election highlighted sensitivities about trade issues in general and pressure from outside bodies in particular. However, in the face of a WTO deadline of 1 October 2000, the US government proposed a compromise reform of its legislation that would, in effect, replace FSC exemptions with a general measure of tax relief on a proportion of all the foreign income earned by US companies; a change that would, in the view of the US authorities, bring US practice into line with that of many European countries.

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R.J. BARRY JONES

formal theory

Formal theories, such as GAME THEORY or RICHARDSON PROCESSES, emphasize two features: strict definition of the relevant concepts and a strict awareness of the logical rigour of the moves from one proposition to the rest.

The concept of a theory is the same as one expressed verbally, but theories are clarified and can be extended by their formulation in formal terms. Thus, in international relations (IR), the concept of 'balance of power' is expanded (and the implications of the assumptions seen more clearly) when it is expressed in formal terms rather than in natural language, which is usually less precise.

'Formal' is sometimes used as a synonym for 'mathematical', but it is also common to regard the mathematical as a subset (albeit an important one) of the broader class of formal theories. Mathematical theories normally set out the initial postulates of the theory and use mathematical arguments to proceed from these postulates to reach the conclusions which are logically implied. However, some formal models (as in many analyses of the single play of the PRISONERS' DILEMMA) do not work things through so precisely because some aspects of the problem do not allow themselves to be dealt with in that way. To identify a situation as prisoners' dilemma (or any other game) clarifies the nature of the conflict and indicates its problematic nature, without necessarily going through any explicit mathematical analysis. However, the original game theory was mathematical in the strict sense. Problems were stated in rigorous forms and theorems deduced from these. This gave great insights into the nature of conflict, but still left open many issues. Thus, the concept of RATIONALITY in conflict situations is thrown into doubt by analysis of prisoners' dilemma, and of chicken and other simple games. These 'mathematical pictures' often show the ambiguity of concepts such as rationality in conflict situations. Clearly there is also a lot of deductive work involved, even in these pictures, but it is the statement of the problem which is the most revealing thing.

The two primary motives for stating theories in formal terms are, first, to see the implications of a theory when laid out rigorously and, second, to lay them out in forms suitable for statistical testing. Formal theories often show that processes are counter-intuitive in ways not revealed by natural language alone. The

clarification of a number of problems, including substantive problems such as deterrence, has been a big achievement of formal theory. Analyses are often done on theories which are simplified versions of the real world. Thus they are referred to as 'models' rather than 'theories', for theories should be amenable to direct empirical testing.

Formal methods are frequently but incorrectly associated with the realist theory of IR. Though much formal work has been done under the realist banner, there is no necessary association between realism and formal methods.

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MICHAEL NICHOLSON

forward market

A forward market is one in which promises to buy or sell goods or securities at fixed prices at some date in the future are bought and sold. An example of a forward market is the forward exchange market, where contracts are made to supply currencies at fixed dates in the future at fixed prices – for example, in three months or six months hence. The difference between the rate of exchange and the forward rate is determined by the rate of interest and the exchange RISK.

See also:

exchange rate; foreign exchange; interest rates; spot market

ALISON M.S. WATSON

Four Tigers (Asian)

The Four Tigers (or Four Dragons) was a name applied to Hong Kong, Singapore, South Korea and Taiwan, a group of NEWLY INDUSTRIALIZED COUNTRIES (NICs) that grew extremely rapidly beginning in the 1960s on the basis of export-oriented growth strategies (see EXPORT-ORIENTED INDUSTRIALIZATION (EOI)). Hong Kong became an exporter of light manufactures in the 1950s. In Taiwan, outward-oriented reforms began in 1958. South Korea's economic expansion followed a military coup in 1961. Singapore launched important reforms after 1967 that made the city-state a major site for foreign investors.

A number of controversies surround the success of the Four Tigers. First, the countries are very different in their endowments and policies, and it is unclear that their success is due to a common model. By virtue of their size, Hong Kong and Singapore were long-established free ports relatively open to foreign trade and investment. Nonetheless, Hong Kong's exports came largely from Chinese entrepreneurs, while Singapore's development rested overwhelmingly on foreign investors. Taiwan and South Korea had pursued inward-looking, import-substituting strategies in the 1950s, and had to contend with the transformation of large agricultural sectors. But Taiwan paid more attention to agriculture than South Korea and had a better distribution of income as a result.

Neo-classical accounts (see NEO-CLASSICAL ECONOMICS) emphasize a combination of macro-economic stability, exchange-rate devaluations and trade LIBERALIZATION as the central reforms in the Four Tigers. But both South Korea and Taiwan continued to combine some protection for imports with various export promotion measures. South Korea was particularly aggressive in using SUBSIDIES and restricted FOREIGN DIRECT INVESTMENT (FDI) to a much greater degree.

More heterodox accounts emphasize the role of industrial policy and government measures to stimulate high levels of private investment.

In the 1990s, scholarly attention shifted to the role of sheer capital accumulation as the key variable in the growth of the Four Tigers. But productivity gains were also substantial and, by the 1980s, all four countries had diversified into more capital-, skill- and technology-intensive products. The financial crisis of 1997–8 resulted in deep recessions in South Korea and Hong Kong, but by the end of 1999 growth had resumed.

See also:

Asian corporatism (AC); Asian crisis; Confucian model of development; East Asian model; exchange rate

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STEPHAN HAGGARD

Fourth World

The term 'Fourth World' was introduced to differentiate the poorest of the world's LESS-DEVELOPED COUNTRIES (LDCs) from their economically more vibrant fellows within the

wider grouping of the 'THIRD WORLD'. Members of the Fourth World are characterized by very low, static or even declining levels of income and wealth (measured in terms of GROSS NATIONAL PRODUCT (GNP) per capita), and poor or non-existent developmental prospects. Natural resource endowments are sometimes poor, international debt levels are often high (relative to GNP and/or export earnings), and there may have been a record of political instability. Explanations for the plight of Fourth World countries range from the consequences of COLONIALISM and the impact of global CAPITALISM to the failure to develop robust governmental institutions and a general culture that is conducive to sustainable economic development.

R.J. BARRY JONES

Frank, Andre Gunder (1929–)

Andre Gunder Frank was born in Berlin. His family left Germany when he was four years old and emigrated to the United States in 1941. He attended high school in Michigan, where he became known as Gunder, graduated from Swarthmore College in 1950 and did graduate work at the universities of Chicago and Michigan, before completing his Ph.D. in economics at Chicago in 1957. His dissertation and early work considered the concept and measures of general productivity, and the contribution of human capital to economic growth. Early publications include considerations of WORLD BANK country reports and organization theory. An interest in anthropology led Frank to co-chair the theory sessions at the 1959 meetings of the American Anthropological Association with Margaret Mead.

Frank taught at Michigan State and Wayne State before going to Latin America in 1962. In 1963 he wrote three critical works. The first, 'Not feudalism – capitalism', rejected prevailing concepts of the dual society as well as arguments that Latin American 'feudalism' was responsible for UNDERDEVELOPMENT and must be replaced with capitalism for there to be

progress. The second, revised and published in 1967 as 'Sociology of development and the underdevelopment of sociology', rejected the idea that underdevelopment was an original condition or that 'traditional' societies went through any 'STAGES OF GROWTH'. The third work, placing all of these arguments into an explicit world-system context, was titled *On Capitalist Underdevelopment* but not published until 1975. From this broad view, the capitalist system of production polarizes societies as well as states (see CAPITALISM). The polarization of rich and poor within capitalist societies is generally understood. Once Europe integrated the rest of the world into a single system during the sixteenth century, the development of rich/central and poor/peripheral countries can be seen. The THIRD WORLD was not the locus of some original or pristine UNDERDEVELOPMENT, but was actively underdeveloped by its colonial, FREE TRADE and then financial and aid relations with the West. Economic surplus was extracted and social systems were altered, giving rise to a class system that reproduced this relationship to the perpetual disadvantage of both the masses and local/national capital. Frank argued that 'if we are to understand the Latin American problematique we must begin with the world system that creates it ...' (1965: 231) and coined the term 'development of underdevelopment' in 1966. Frank worked throughout Latin America, with short stints at the Economic Commission for Latin America (ECLA/CEPAL) and the INTERNATIONAL LABOUR ORGANISATION (ILO). He taught in Mexico, Brazil and Chile, before being forced into exile by Pinochet's 1973 coup. Frank wrote or edited twenty books and over 150 articles and chapters during this period that helped 'the DEVELOPMENT OF UNDERDEVELOPMENT' mature into DEPENDENCY THEORY and the world-system perspective.

Frank turned to the question of crisis in the world-system in the 1970s and early 1980s. His conceptualization of the dynamics of crisis builds on the logic of Kondratieff and MANDEL. KONDRATIEFF WAVES find increasing prices, production, technological innovation and profits. Profits eventually decline, as the

ratio of capital to labour grows too high during a boom. Investment declines and there develops a preference for cost-saving rationalization. Economic downturns born of over-accumulation eliminate some capitalists and destroy the ability of labour to maintain high wages. When profits are restored, it becomes rational to resume investment, which rekindles growth and signals a new upswing.

Liberal economists, adopting models unsuited to the task of understanding (much less helping to ameliorate) periodic downturns, are criticized in articles like 'Equating economic forecasting with astrology is an insult – to astrologers' (1978) and in the opening chapter of Frank's *Crisis* volume (1980). Frank reviews the increasing number and ferocity of recessions in the West and the manner in which Western states chose to address the problem. First through credit expansion (including via military adventurism), then by direct wage-price controls and support for recessions that will reduce wage packets, liberal economists and policy-makers adopt measures to bring forward the interests of owners of capital against the interests of the majority. Policies, especially those to control inflation, focus on austerity, reducing social programmes and welfare, and then on curtailing wages and/or employment.

Much of Frank's analysis of crisis is focused on its impact in the Third World. Crisis is transmitted from the West to the South through BALANCE OF PAYMENTS problems. As Western demand for RAW MATERIALS falls, Third World TERMS OF TRADE and revenues decline. Debts increase and austerity programmes are imposed by international lending institutions. Three manifestations are particularly noteworthy. First, industries flee high-wage countries in search of lower costs. Newly disciplined Third World governments are transformed into desirable targets for transnational capital, complete with cheap, well-disciplined labour force and offers of substantial SUBSIDIES (providing physical plant, excusing taxes, even directly offsetting wages) in the hope of generating hard currency. A second manifestation is repression. The state mobilizes

against its population to impose the discipline demanded by creditors. Repression must continue in support of those policies. Frank is particularly wary of alleged moves toward political LIBERALIZATION. These 'liberal' movements are often led by former populist leaders who are rehabilitated by the majority, despite their increasingly conservative political platforms, as they constitute one of the few viable alternatives to military rule. The final change concerns possible future trajectories. While a few Third World states are large enough to attract industry that will serve the domestic market and provide an incentive for wages to increase, most must adopt a strategy of export-promotion that does not include local consumption. Hence there is every incentive to keep wages perpetually low. For most of the Third World the promise of capitalist development must forever ring hollow. Frank spent the late 1970s and 1980s writing on manifestations of crisis and (with Marta Fuentes) on social movements in ten books and over one hundred articles and chapters.

This same crisis would afflict the socialist countries, which Frank suggested had never fully separated from the global capitalist economy in the first place. In the midst of difficult economic times, East and West expressed complementary needs. To offset economic downturns, the West needed to export, while the East needed to import. The expansion of East-West trade ushered in the era of West-East lending, which tied the socialist bloc to the West via an expanding debt. These pressures were joined by a splintering of the socialist bloc. Chinese enmity toward the USSR was taken full advantage of by the United States, while socialist rivalries in South-East Asia destroyed any pretence of solidarity. Frank's 'Long live transideological enterprise! The socialist countries in the capitalist international division of labor' (1977) traced the link between East and West, as well as between North and South. Eastern bloc imports of Western technology and repayment of Western debts were financed by revenue earned from trade with the periphery. Socialist exports to

the West were two-thirds raw materials and one-third manufactures. But exports to the Third World were two-thirds manufactures and one-third raw materials. Hence the socialists played an intermediate role in the global division of labour, East–South interaction being similar in form to West–East interaction.

By the middle of the 1980s, Frank turned again to tracing the origins of the world system, and found it far older than had been generally accepted. Doubts over just how far back one needed to go to find the roots of the present system were strengthened by Janet Abu-Lughod's *Before European Hegemony: The World System A.D. 1250–1350* (1989). Frank's first paper on the issue was read by Barry Gills, who had worked on this question as well. They began a fruitful collaboration in WORLD SYSTEM (without the hyphen) history.

Tracing world system history back before capitalism forced a reconsideration of Frank's earlier positions. If the world system evidenced the same dynamics both before and after the advent of capitalism, then capitalism itself must be less than central to the functioning of that system. Frank argued for the abandonment of concepts like MODE OF PRODUCTION in 'Transitional ideological modes: feudalism, capitalism, socialism'. He argued instead that LONG CYCLES of global rise and decline stretching back some 5,000 years to the onset of systematic relations between Egypt and Mesopotamia could be identified. Accumulation on a world scale thus had to be described and explained back through the millennia. These ideas, others like them and a variety of criticisms are brought together in *The World System: Five Hundred Years or Five Thousand?* (Frank and Gills, 1995).

Next to be questioned was the idea, inherent in most Western social and world-system thinking, that the West possessed exceptional attributes that explain its rise to dominance and that it was the first region to successfully structure the rest of the world in its wake. Europe did not so much rise as Asia declined. Starting at the end of the mid-fourteenth century crisis, where Abu-Lughod leaves off, Frank describes a dense web of global trade

relations centred in a clearly dominant Asia. As global trade and production increased in a long-cycle upswing, the more advanced Asian regions grew richer. Europe was unable to sell its high priced and technologically backward goods, so its states sponsored the search for specie. The exploitation of American gold and silver allowed Europe to trade with Asia and eventually control inter-Asian transport as well. American silver poured into Asia, a labour-rich but resource-poor area. Wages remained low and production increases were built on labour-intensive methods. Income was poorly distributed and political upheaval followed. In Europe, labour shortages and a wealth of resources led to high wages (higher domestic consumption and relative political stability) and the drive to expand technology. As technology increased production and decreased costs, eighteenth-century Europe eclipsed a slowly declining Asia, but not as a pristine region with unique attributes that created the first world-system. Instead, Europe rose (and Asia fell) within the confines of and consistent with the incentives provided by an existing world system. The reverse could happen as well, as the West depletes its resources, increases inequality and cedes production and technological development (back) to (supposedly 'new') Asian producers.

Hence ideas about development based on unique attributes of Western society or culture were unfounded, as were suggestions about the difficulties to be faced by those from non-Western societies or cultures. With these criticisms of everyone from WEBER and MARX to BRAUDEL and WALLERSTEIN, Frank calls for no less than a complete rethinking of the nature of the world system, its past and its future, in *ReOrient: Global Economy in the Asian Age* (1998). In all, Frank has written or edited thirty-seven books and nearly 400 articles and chapters, many reprinted numerous times in some thirty languages.

See also:

capitalist crisis; debt crisis; dependency theory;

free on board (f.o.b.)

development of underdevelopment; world-systems theory

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ROBERT A. DENEMARK

FREE ENTERPRISE ZONES *see* export-processing zones (EPZs)

free on board (f.o.b.)

Free on board (f.o.b.) is one of thirteen international commercial terms (INCOTERMS) developed by the INTERNATIONAL CHAMBER OF COMMERCE (ICC). It means that sellers fulfil their obligation to deliver when the goods have passed over the ship's rail at the named port of shipment. The buyer has to bear all costs and risks of loss or damage to the goods from that point.

The term can only be used for sea or inland waterway transport. When the ship's rail serves no practical purpose, such as in container traffic, different INCOTERMS are more appropriate.

See also:

cost, insurance, freight (c.i.f.)

AXEL HÜLSEMEYER

free rider problem

A free rider problem exists when actors benefit from the consumption of a COLLECTIVE GOOD while not contributing to its production. Those who benefit while not bearing the costs of producing a collective good are known as free riders.

The free rider problem exists at every level of society, from individuals to domestic politics to international politics. At the individual level, free riders listen to public radio services while not paying dues. At the domestic level, districts that expend little on education free ride on those that provide an adequate education to their constituents. On the international level, those states which pollute heavily free ride on those which take costly steps to limit pollution. The collective goods at stake in these examples are public-radio programming, an educated citizenry and a clean environment, respectively.

While he did not use the language of free riders, the seminal work on the free rider problem is nevertheless Mancur Olson's *The Logic of Collective Action* (1965). Olson analyses the dilemma of collective action, showing that PUBLIC GOODS (goods that are non-rival and non-excludable) will tend to be under-produced since actors will have an incentive to free-ride on the actions of others. Because public goods are, by definition, non-excludable, those who fail to contribute to their production cannot be prevented from enjoying their benefits. Therefore, such goods will be produced at a sub-optimal level, if at all. Olson argued that the production of public goods would be increased if they were linked to the provision of private goods; for example, a public radio station may offer contributors a tax-deductible gift. Alternatively, the free rider problem could be solved if one or just a few actors were large enough to derive a large share of the benefits of a public good. It would then be in their interest to bear the costs of producing the good. Thus, the public good of international security might be provided by a hegemonic state, such as the United States during the COLD WAR.

Analysis of the free rider problem has contributed significantly to studies of international COOPERATION and international regimes. The problem of international cooperation is starkly presented when we consider the incentives of states to free-ride on one another's cooperative efforts (Oye, 1986). Consider a typical international collective dilemma, such as protection of the ozone layer. Having in place an adequate ozone layer is a global public good, in as much as it provides protection against skin cancer for all, and since even states that produce substances that harm the ozone layer would benefit from global efforts to protect it. Each individual state may calculate that their individual efforts to protect the ozone layer are costly, since they involve use of expensive chemical substitutes, and on their own such efforts will have little impact on the overall quality of the ozone layer. Thus, each state is tempted to free-ride. Overall, this logic (like that of the PRISONERS' DILEMMA) leads

states to over-use of substances that harm the ozone layer and to under-production of the public good.

International cooperation is required if states are to move away from the sub-optimal outcome in which all free-ride. If such cooperation can be established, all states will be better off than if they all free-ride. However, the conditions for cooperation in international politics are stringent. No external authority exists that can force states to cooperate with one another. Relying on their own devices, states can overcome incentives to free-ride and so gain the benefits of cooperation only if they interact with one another in a regular manner and have good information about each others' actions. In other words, they must devise a self-enforcing contract.

Robert O. Keohane (1984) further developed the theory of international cooperation, bringing international institutions into the picture. His work built on studies of international regimes (see Krasner, 1983). Keohane, drawing on the theoretical work of Ronald Coase, considered the conditions that would allow states to overcome impediments to mutually beneficial cooperation, especially incentives to free-ride. He argued that states could find ways in which to cooperate with one another if they valued having a reputation for living up to international agreements. In this situation, states would be reluctant to free-ride since this would harm their reputation, thus excluding them from future benefits of international cooperation.

However, reputation can only sustain cooperation and overcome the temptation to free-ride if states value future cooperation and if they have good information about one another's actions and intentions. Keohane thus draws attention to mechanisms that can increase the shadow of the future and the quality of information in the international system, particularly international institutions. Such institutions do not directly enforce agreements, as institutions often do on the domestic level; instead, they create the conditions under which states can devise self-enforcing agreements. International institutions are therefore a major solution to the free rider problem.

free trade

The preceding line of analysis has been criticized on both analytical and empirical grounds. Analytically, many cooperative problems do not fit the model of a public good or a prisoners' dilemma, so the focus on free-riding as the major impediment to international cooperation may be misplaced. Empirically, studies of the effects of international institutions are still in their infancy. However, in spite of these critiques, consideration of the free rider problem has led to a dramatic shift in understanding of the functions and effects of international institutions.

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free trade

As a descriptive term, 'free trade' refers to the absence of government policies designed to regulate international trade, especially import limitations such as **TARIFFS** or **QUOTAS**. It was first used as a political slogan at the end of the sixteenth century, in opposition to medieval guild regulations and government grants of monopoly, both of which restricted which individuals were permitted to engage in com-

merce. Since the eighteenth century, however, the free trade question has been concerned with whether government should influence the prices and quantities of traded products, rather than whether they should stipulate the identity of the merchants.

Free trade took on its modern meaning during the 1690s controversy over the importation of Indian cotton calicos into England, when prevailing mercantilist sentiment favoured restrictions on that trade in order to protect English wool producers from foreign competition (see **MERCANTILISM**). Advocates of free trade contended that merchants should establish the prices and quantities of traded goods in conjunction with markets that represented supply-and-demand conditions, without the interference of price distortions induced by trade barriers. Later the debate over the English **CORN LAWS** spurred the evolution of the free trade arguments of **ADAM SMITH**, **DAVID RICARDO**, James Mill and **JOHN STUART MILL**, which coalesced into the core of the classical liberal school of economics. Because the argument advanced for free trade is now so deeply imbedded in the economic theory associated with classical and neo-classical liberalism, the term has acquired a theoretical cast that dominates its nominal definition. In fact, since no government completely forgoes trade regulation, free trade has become a prescriptive theoretical ideal rather than a descriptive empirical concept.

Although the prescription for governmental non-interference with trade also can be found in competing theoretical orientations (most notably eighteenth-century physiocracy), the doctrine of free trade is now regarded as a simple extension of liberal theory's basic claim that markets will maximize the efficient allocation of resources whenever unfettered by government interference. Adam Smith is credited with the first systematic exposition of the theoretical analysis of free trade, but its key idea is an application to international trade of the argument concerning the gains attributable to the **DIVISION OF LABOUR** that had been known as early as Plato. Even Smith's contribution was anticipated at least a century

earlier, especially by Henry Martyn, but the free trade argument was not fully established until J.S. Mill's influential text *Principles of Political Economy* (1965 [1848]) honed and formalized the ideas of Smith and, especially, Ricardo. Ricardo's principle of COMPARATIVE ADVANTAGE, illustrated by the famous example of Portuguese wine exchanged for English cloth, but anticipated by James Mill and Robert Torrens, has become the heart of the theoretical case for free trade. Ricardo demonstrated that almost any pair of nations could maximize their joint consumption if each specialized in the production of the good they produced most efficiently and then exchanged those goods freely. Following Smith, he argued that the benefits of trade would arise whenever government abandoned the trade barriers and other economic interventions which prevented private economic actors from pursuing their private interests. By contrast, whenever market allocation is replaced by government setting of prices and quantities – or even when government policies shift relative prices by taxing, subsidizing or otherwise affecting the costs of trade – the result will be diminished efficiency and declining welfare for the international trading system as a whole.

The free trade prescription has been challenged not only by advocates of the classical MERCANTILISM which spurred the initial creation of liberal theory, but by later developments like the NEO-MERCANTILISM of theorists like FRIEDRICH LIST, the more modern protectionism associated with IMPORT SUBSTITUTION INDUSTRIALIZATION (ISI) and the full-employment emphases of JOHN MAYNARD KEYNES. Challenges to the logic of free trade have also arisen from advocates of INFANT-INDUSTRY PROTECTION and, most recently, STRATEGIC TRADE THEORY and INDUSTRIAL POLICY.

Within the liberal school, rigorous studies of alternative economic policies no longer focus on the simple concept of free trade, because its historical emphasis on direct trade-controls does not address the complexity of modern policy tools. Instead, it is being replaced by more detailed analyses of the net biases induced by the many government policies

which shift relative prices among exporting, import-competing and non-tradable sectors of the economy (especially in exchange-rate management and taxation). However, because the free trade argument remains the outstanding symbol of liberal theory's basic theoretical, methodological and philosophical outlook, it continues to be the main target of many challenges from critics of liberal principles. Indeed, the free trade debate endures as the greatest crucible of ideological controversy in modern international political economy, turning on fundamental questions concerning the appropriate goals of government policy, the relative merits of market-based and state-based allocation, and the propensity of markets to yield undesirable distributional outcomes (especially inequality) and other social and political consequences.

See also:

absolute advantage; free trade imperialism

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free trade area (FTA)

A free trade area (FTA) is a regional bloc made up of two or more countries which agree to liberalize their bilateral trade, while maintaining their restrictions on trade with third countries. In practice, LIBERALIZATION is confined to elimination of tariffs and quantitative restrictions at the border, and applies only to certain industries or products.

free trade imperialism

For example, the EUROPEAN FREE TRADE ASSOCIATION (EFTA) excludes agricultural products. The many FTAs that have been concluded by the EUROPEAN COMMUNITY (EC) contain numerous exceptions applying to agricultural products and certain other 'sensitive' products (such as textiles and steel). These exceptions are in apparent breach of Article XXIV of the GENERAL AGREEMENT ON TARIFFS AND TRADE (GATT), which requires that preferential trade agreements such as FTAs and CUSTOMS UNIONS (CUs) should eliminate restrictions on 'substantially all trade'.

Because the members of an FTA retain autonomy in trade policy and do not harmonize their trade measures with respect to non-members, they also operate 'rules of origin' whose purpose is to prevent 'trade deflection'. Trade deflection occurs when third-country products enter the FTA through the member-country that maintains the lowest tariff. Rules of origin, therefore, define the goods which are considered to be produced by member-countries and which qualify for tariff-free access.

The trade and welfare effects of FTAs have been analysed in conjunction with customs unions in the literature on ECONOMIC INTEGRATION and preferential (or discriminatory) trade agreements. As in the case of customs unions, an FTA does not necessarily improve the welfare of its members because the benefits from increased trade with the partner-countries may be outweighed by the costs of foregone tariff revenue and the substitution of more expensive partner-products for cheaper third-country products. Unless partner-countries happen to be the most efficient producers, an FTA can be improved on by unilateral and non-discriminatory liberalization. In addition, FTAs do not confer on their members greater bargaining and market power, because they do not adopt a common tariff as in customs unions. For these reasons, the theoretical literature has considered FTAs as sub-optimal trade arrangements. However, they have not been analysed as exhaustively as customs unions.

In contrast to the doubts raised in the theoretical literature concerning the economic rationality of FTAs, most of the hundred or so preferential trade agreements that have been notified to GATT take the form of partial FTAs (they are partial in the sense that they do not cover substantially all trade between member countries, or they do not completely eliminate border restrictions, or they do not provide for completely reciprocal liberalization by all members).

See also:

trade creation and trade diversion

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PHEDON NICOLAIDES

free trade imperialism

This seemingly self-contradictory notion refers to a particular type of IMPERIALISM based on the liberal economic doctrine of FREE TRADE. According to this notion, states with dominantly competitive economic power force weaker states to open their markets and to trade freely, so that the dominant states may gain access to export markets and cheap imports, and ultimately establish informal political control over economically backward states. In discussing free trade imperialism, it is useful to distinguish it from both eighteenth-century MERCANTILISM and the formal imperialism prevalent in the late nineteenth century. It differs from mercantilism in that the latter discouraged free trade; on the other hand, it differs from formal imperialism in that the form of control in free trade imperialism is primarily economic, while formal imperialism

often took the form of political or military occupation of colonies.

The cardinal case of free trade imperialism is British trade policy in the mid-nineteenth century. The United Kingdom had, by then, achieved the status of the workshop of the world as a result of the INDUSTRIAL REVOLUTION. Accordingly, policy-makers, business groups and intellectuals began to consider that conventional protectionist trade policy rather restricted the country's economic growth. Manufacturing interest groups, in particular, advocated free trade since they viewed it as a useful means to increase cheap raw material imports and to expand exports. The fact that free trade became a dominant economic ideology during this period may have had such political as well as intellectual origins. As a result, the United Kingdom began to aggressively advocate free trade policy in the 1840s. The exemplary incident that reflects the British free trade imperialism was the OPIUM WARS (1840–2). In justifying the use of force against China, the British argued that China's restriction on the opium trade violated free trade principles. It is ironic that free trade, which was regarded by RICHARD COBDEN and other intellectuals as the vehicle of world peace and prosperity, became the preferred means to maintain or enhance British dominance in the world market.

The aggressive free trade policy pursued by the United Kingdom failed to win support from many economically backward states. Instead, it ironically caused the rise of economic nationalism. In Germany, FRIEDRICH LIST argued that free trade merely served the interests of the United Kingdom at the expense of other states, and that other countries should not submit to it but should instead search for better means to enrich their own national interests. Japan, which viewed the opium wars as the imperialist aspect of free trade policy, accelerated efforts to catch up with European powers by national economic policy in order to secure its survival.

The concept of free trade imperialism still provides a useful lens through which to analyse recurring debates on some trade issues,

although the word 'imperialism' has become somewhat obsolete. During the 1960s and 1970s, those who advocated DEPENDENCY THEORY argued that the liberal international economic system was perpetuating unequal economic development between industrialized and developing countries by creating the latter's dependency on the former. Even after dependency theory had begun to lose prominence, initiatives for trade liberalization by the United States and the INTERNATIONAL MONETARY FUND (IMF) have been often criticized by developing countries as intervention by advanced capitalist states.

See also:

capitalism; Frank, Andre Gunder; hegemony; Hobson, J(ohn) A(tkinson); Lenin, Vladimir Ilich

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YASUHIRO IZUMIKAWA

FRENCH FRANC ZONE see Communauté Financière Africaine (CFA)

FRENCH INSURANCE COMPANY FOR FOREIGN TRADE see *Compagnie française d'assurance pour le commerce extérieur* (COFACE)

Friedman, Milton (1912–)

Milton Friedman, an Emeritus Professor of Economics at the University of Chicago and a Senior Fellow at the Hoover Institution, became the 1976 Nobel laureate 'for his achievement in the field of CONSUMPTION analysis, monetary history and theory, and for his demonstration of the complexity of stabilization policy'. A leader of the CHICAGO SCHOOL, a principal exponent of MONETARISM and an ardent advocate of free-market ideas since the 1960s, he is considered by many to be the most influential economist of the twentieth century, together with JOHN MAYNARD KEYNES.

Friedman studied economics as a graduate student at the University of Chicago, but he obtained his Ph.D. from Columbia University. After working in various federal agencies from 1935 to 1943, he joined the University of Chicago in 1946, teaching there until his retirement in 1979. He was also affiliated with the National Bureau of Economic Research (NBER) from 1937 to 1981. In 1951, he won the John Bates Clark Medal and, in 1988, the Presidential Medal of Freedom. He has served as economic adviser to Richard Nixon and Ronald Reagan, and as President of the American Economic Association.

His main contribution to consumption analysis is his theory on people's consumption as a function of their expected lifetime earnings (permanent income hypothesis); to monetary theory, his correlation of price level with money supply and his money supply rule (money supply should increase at the same rate as real GROSS NATIONAL PRODUCT (GNP)). He also made substantial contributions to economic methodology and the theories of human capital, distribution, unemployment and so on.

In a number of books written for a wider audience, especially *Capitalism and Freedom*

(1962) and *Free to Choose* (1980), he supported free markets and FREE TRADE, including freely FLOATING EXCHANGE RATES (arguing that speculators tend to stabilize the exchange rate).

See also:

monetarism; neo-liberalism

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ARISTIDES N. HATZIS

Fukuyama, Francis (1952–)

Francis Fukuyama, a conservative American commentator on world affairs, has developed several highly contentious theses about the nature of modern capitalism. In 1989, Fukuyama asserted that the collapse of communism signified not only the end of the COLD WAR 'but the end of history itself as such: that is, the end point of mankind's ideological evolution and the universalization of Western liberal democracy as the final form of human govern-

ment' (Fukuyama, 1989: 4). Fukuyama's thesis was based on an interpretation of Hegelian philosophy which argued that history is driven by rival ideologies. For Fukuyama, the twentieth century had witnessed a conflict between communism, fascism and liberal democracy, with the latter emerging triumphant.

Fukuyama's thesis has been roundly criticized, not least for asserting that 'the class issue has actually been successfully resolved in the West' (ibid.: 9) and contending that POVERTY should now be attributed to the cultural and social characteristics of the poor (for example, black poverty should be seen as the legacy of RACISM and slavery). Richard Peet has argued that NATIONALISM and religion cannot be dismissed so easily as challenges to the liberal democratic state, as illustrated by the resurgence of Islam as 'a negative reaction to Westernization which reverses the homogenization of liberal capitalist society' (Peet, 1993: 73-4). Furthermore, Fukuyama's 'theory of endism' has over-emphasized 'the predictability of history and ignores the weakness and irrationality of human nature' (ibid.: 68). Because of Fukuyama's assumption that 'liberal democracy is guided by Reason incarnate, armed with overwhelmingly destructive weaponry', Peet has concluded that his ideas might indeed 'bring about the end of history!' (ibid.: 76).

More recently, Fukuyama has contended that social capital – that is, 'the ability of people to work together for common purposes in groups and organizations' – 'is critical not only to economic life but to virtually every other aspect of social existence as well' (Fukuyama, 1995: 10). Because wealth-creation appears dependent on activities undertaken in groups rather than in individual isolation, Fukuyama has argued that the trust arising from social capital and shared values in Japan and similar civil societies has had a major impact on industrial organization and economic performance. However, Fukuyama's thesis has been undermined by his failure to provide detailed empirical evidence for his contention that social capital can explain 'a missing twenty percent of human behaviour

about which NEO-CLASSICAL ECONOMICS can give only a poor account' (ibid.: 13).

See also:

developmental state

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SIMON LEE

functionalism

'Functionalism' is the term used to connote a prescription for INTERNATIONAL RELATIONS (IR) that is credited primarily to David Mitrany. Mitrany's prescription holds that the creation of an international community with appropriate institutions will follow gradually from discrete efforts to cooperate in solving common presenting problems, thereby constructing 'a working peace system' (Mitrany, 1966). Functionalism offers both a practical guide to action and an intellectual guide to comprehension. Although it deservedly has prompted generations of academic critics to expose its shortcomings, functionalism's influence continues to be far greater than its recognition.

Appreciation of the dynamics expected to bring about peaceful change in a manner subsequently called the 'functional approach'

did not begin with Mitrany (Sewell, 1966; Long, 1993). Nor is Mitrany responsible for the suffix '-ism' now used to facilitate a shorthand version of what he had called 'the functional development of international organization'. But Mitrany it was who drew together others' insights with his own observations, formulated an appealing argument and advanced this argument during a critical juncture in human affairs (Mitrany, 1966).

Functionalism's practical application envisages that community will be built function by function. The adaptable structures to anchor this process would follow a Mitrany-like precept that 'form follows function'. Mitrany's argument accepted the world of insecure, belligerent states (see STATE, THE) competing with and for POWER as the starting point for the functional process. On behalf of otherwise unmet needs of their citizens, governments would pool their states' SOVEREIGNTY, not surrender it. Functional units would bring together experts to reckon with significant problems on which sufficient CONVERGENCE existed to permit intergovernmental organizing while minimizing controversiality in doing so. For the most part, the specialized agencies of the United Nations would provide fruitful examples of functionalism. as would units with smaller memberships such as the EUROPEAN COAL AND STEEL COMMUNITY.

Furthermore, other conditions seemed propitious. For its transformative process, functionalism required distinct functional units established at a distance from each other and separate from any 'political' organs, and this, superficially at least, appeared to be realized in practice. After all, the United Nations Security Council and the UN General Assembly ordinarily met in New York, while the UN specialized agencies reached out from bases elsewhere. The growing participation of INTERNATIONAL NON-GOVERNMENTAL ORGANIZATIONS (INGOs) in functional agencies augured well for the weaving of peaceable webs of transnational ties across NATION-STATES. Given such auspicious circumstances, organized functions could be expected not only to alleviate the problems that had spurred the institution of their agency in the first

place, but also eventually to overlay territorial boundaries with sinews of CIVIL SOCIETY and thereby mitigate propensities to make war. Moreover, functionalism would habituate individuals who worked together to new ways of cooperation and away from previous ways of confrontation. Meanwhile, people near functional operations at various locations the world over could observe and learn the benefits of collaboration from their work. The phrase 'peace by pieces' seemed to distil the peace-building outcomes to be anticipated from functionalism (White, 1946).

Functionalism differs from FEDERALISM as an approach to organizing international life. Whereas federalism demands explicit commitment by the governments of states or other territorial units to a durable if constitutionally limited arrangement, functionalism assumes that the willingness to cohabit peaceably in global community can be pursued incrementally as a series of small steps. Indeed, functionalism even seems to assume that the coming of global community does not require knowing consent. To federate partakes of high public drama; to realize community by functional dynamics implies low public awareness, if not sustained public sleepwalking. In a period marked by militant groups' extremely vigilant opposition to GOVERNANCE on all levels of human relations, functionalism's anticipation of minimal consciousness about significant global developments seems curiously misplaced.

Mitrany's argument has enjoyed the support of Hans J. Morgenthau (Mitrany, 1966), identified with realist and neo-realist schools of international politics (see NEO-REALISM; REALISM). It has also influenced directly a number of IR scholars who have acknowledged their intellectual debt to the argument, as well as others who perhaps do not recognize its impact on their conceptualizing. Yet even scholars who find in functionalism an attractive argument have criticized its postulates.

Functionalism assumes the separability of non-controversial yet important economic, social, humanitarian and technical matters from controversial political ones. Yet, while

non-controversial matters are being treated functionally, and because of the successes of this process, the controversial area of politics will (in the estimation of functionalists) be shrunk. The functionalist contention puts politics doubly on the defensive, first as functional agencies are created and then as their activities ramify, feeding back such conditions of concord that 'technical self-determination' (Mitrany, 1966) increasingly replaces politics as we have known it. But are the expectations about initial separability followed by transformative feedback logically consistent with each other? Does the empirical world of today suggest that politics has been segregated in practice from matters described by more substantive labels? Has any amelioration of economic, social, humanitarian and technical problems not tended to depend on political decisions, rather more than political decisions depend on progress in 'non-controversial' matters (Claude, 1956)?

To recognize (or even welcome) politics serves as one alternative or corrective to functionalist expectations. The presence of politics places a seal of importance on an endeavour; only if this endeavour is deemed to matter can the effort bring about peaceful change. Put somewhat differently, politics raises the salience of a problem to an extent that is apt to be necessary if governments are led to take this problem seriously. Only if it is taken seriously can it be effectively treated. And only if it is effectively treated can a condition of functional change be met.

In its role as a guide to comprehension, functionalism likewise better serves when factors of politics, as a motive force, augment its other aids for discerning what happens and why. Politics shapes the establishment phase of functional endeavours even more profoundly than their subsequent change, including any 'politicization'. To analyse and explain phenomena like the UN specialized agencies or 'regional' organizations without the exercise of political acuity will surely take the observer little distance towards understanding. Finally, to focus on politics helps the appropriate placement of responsibility for outcomes on the governments

of member-states, rather than following the governmental tendency to displace responsibility for failures onto reified versions of the international agencies that the governments themselves created and control (Sewell, 1966).

Functionalism offers a research agenda that is rich in possible 'If ... then ...' propositions – propositions that can be derived, refined and tested (Haas, 1964; Sewell, 1966). Functionally specific agencies with universal memberships and their 'regional' counterparts with particular memberships make up a burgeoning universe of tempting opportunities for investigation. And the extended period of time that is a theoretical condition for realizing the fruits of functional change has now had a chance to expire with respect to the maturation of many agencies. In other words, many fitting and uncharted research opportunities beckon.

Phenomena vertically linking different levels of the international system, including one or more beneath the state, invite examination. The growth of intergovernmental functional units parallels the growth of ministries or departments, as well as smaller bureaucratic units within some states. A vesting of interests occurs between organizational units on different levels while these undergo functional partitioning into ISSUE AREAS. The proliferation of NON-GOVERNMENTAL ORGANIZATIONS (NGOs), providing bridges between these levels, signals progression of the play of interests in inducing structural complexities. One additional symptom of this structural mitosis is governments' complaints (and especially foreign ministries' complaints) about the difficulties of coordinating foreign policy. Another symptom is their complaints about the difficulties of coordinating the work of functional agencies. The new complexities wrought by the vesting of interests across split-level issue areas hardly sound the death-knell for the state. No palpable evidence suggests that this emerging form of interest politics spawns loyalties or transfers them from the nation or other identity reference group. Nor has the process reached the degree of intrigue and notoriety that attends 'iron triangles' within the US political system, linking executive

branch programmes with legislative committees or subcommittees and interest groups. But split-level interest politics invites empirical enquiry while posing questions that increasingly inform the study of INTERNATIONAL ORGANIZATIONS (IOs) as walled institutions, questions such as those concerning transparency, access, representation, oversight and accountability.

Functionalism has been criticized by Soviet writers and some others as a handmaid ideology to the rich and powerful against claims of the poor and weak. This charge proceeds as follows. Western governments establish functional agencies reflecting principles, norms, rules and decision-making procedures that advance their interests without threatening their prerogatives. Though perhaps not thought of or described as such in Western circles, these constitutive acts are political in essence. When governments from the SOUTH become agency members and muster their voting strength in order to seek reoriented agency tasks and procedures, yielding redistributed material support for their advancement in such matters as development and environmental protection, Western founders attack this tactic as 'politicization'. And in some instances, supported by an ideologized version of functionalism that praises the banishment of politics, they succeed in 'fixing' by 'de-politicizing' an agency, thereby eclipsing its autonomy and limiting its agenda, or at least its outputs, to what are seen by critics either as concessions to the mighty or as trivialities. Although this does not justify the reduction of functionalism to an ideology, cases of suppressed politicization within specialized agencies would appear greatly to outnumber cases of reallocated resources for development of the South.

Finally, functionalism serves as orienting ideology for practitioners, especially international public servants. To those with hands-on duties in international organizations, it is apt to provide a sense of direction and to appeal as a rationale for programmed evolution of the WORLD ORDER. In this respect, functionalism's disavowal of politics fits nicely with the

international civil servant's private self-image and public ethic. Also attractive are functionalism's promises of treating the ills of this world, of bringing needed structural change and of doing so by a process of incremental steps leading gradually into a better system that one will have had a hand in bringing about. Yet functionalism provides no substitute for vision.

See also:

epistemic communities; global society; governance, global; integration; interconnectedness; multilateralism; neo-functionalism; spill-over; transnational actors

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futures

A future is an exchange-traded form of forward contract in which is standardized the quantity of underlying asset to be delivered per contract (the contract size), the underlying financial instrument or index, the minimum price movement for the contract (the tick size) and the period of the contract.

It is possible to distinguish between financial futures or interest-rates futures, and currency futures. While in the case of currency futures the underlying asset is always represented by a standardized amount of currency, in the case of interest-rates futures the underlying asset is constituted by a standardized amount and type of securities or by a specified index.

Futures trading was introduced in the Chicago Commodity Exchanges in the mid-1970s. The success of futures contracts in Chicago stimulated the opening of other exchanges, the first of which was the London International Financial Futures Exchange (LIFFE) in September 1982.

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